Recommended 2006/2007 Budget
and
Ten-Year Resource Allocation Plan

City Manager's
Letter of Transmittal

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Honorable Mayor and Members of the City Council:

CITY MANAGER'S MESSAGE

EXECUTIVE SUMMARY

I am pleased to present for your review and consideration the recommended FY 2006/2007 Budget and accompanying Twenty-Year Resource Allocation Plan (RAP). In keeping with Council policy, each fund is balanced to the twentieth year and all reserve requirements have been met. This recommended Budget represents significant progress toward adjusting to the City's new fiscal realities. In addition, it reflects the culmination of a significant effort during FY 2005/2006 to restructure all of the City's programs to the enhanced Performance Based Budget System.

FY 2006/2007 is the first year of the two-year operating budget cycle and the second year of the projects budget cycle. The two-year cycle for operating programs was established to recognize the fact that service levels typically change only modestly from year to year, and that resource requirements can be effectively planned over a two-year time frame. This year, therefore, staff has concentrated on the operating budget, and presents for Council consideration a two-year budget for all operating programs. Since most operating programs are not normally reviewed extensively the second year, a significant amount of staff time is saved. This staff time can be directed toward performing a detailed review of all capital and special projects. Major revenue sources, personnel costs and enterprise activities are reviewed each year in order to ensure the accuracy of our long term projections. The process utilized in preparing the recommended FY 2006/2007 Budget is discussed in more detail later in Appendix A of this Transmittal Letter.

Recommended FY 2006/2007 Budget

The recommended FY 2006/2007 Budget of $237 million for all City funds continues to acknowledge Sunnyvale's new fiscal reality. The level of services included still reflects most of the reductions made in FY 2003/2004, with some restoration in services of high priority to the Council. Assumptions for the City's major revenue sources reflect their specific business cycles. This means that with the recent economic recovery, the recommended budget is projecting marked growth to reflect the upside of the business cycles. On the expenditure side, the recommended budget assumes salaries and the cost of goods and services will increase modestly.

Sunnyvale's new fiscal reality is most clearly felt in our General Fund. This fund accounts for our basic city services and is the one that is most affected by economic conditions. The recommended FY 2006/2007 Budget for the General Fund is $114.6 million. This represents a 5.82% increase over the FY 2005/2006 Revised Budget. The recommended Long Term Financial Plan for the General Fund represents considerable progress toward the City's goal of fiscal stability.

Existing service levels have been maintained, with enhancements in some areas. Last year, the FY 2005/2006 Budget and Long Term Financial Plan for the General Fund included approximately $1.1 million in needed reductions or revenue increases annually for seven years in order to address an ongoing structural gap between expenditures and revenues. An additional structural gap in the Community Recreation Fund was projected of approximately $650,000.

During FY 2005/2006 staff continued to implement cost saving strategies to address the structural gap. Additionally, Sunnyvale voters approved increases to the City's Transient Occupancy Tax and Business License Tax rates which provided additional resources of $1.4 million annually when fully implemented to address our fiscal challenges.

As a result of these efforts, and the improving economic climate, the recommended FY 2006/2007 Long Term Financial Plan does not require any further service reductions. In addition, we are recommending some service level enhancements for consideration through the Budget Supplement process. A Service Level Set-Aside has also been funded at approximately $500,000 annually, and the Capital Improvement Project Reserve has been increased substantially to help address the unfunded capital improvement plan of $433 million. Finally, the General Fund subsidy to the Community Recreation Fund has been increased to support the services that the Council and the community believe are important to the City's quality of life.

Financial Successes and Initiatives in FY 2005/2006

As indicated, the City has made considerable progress toward its goal of long term financial stability during this past year. A number of initiatives undertaken this past year are particularly noteworthy. Some of these initiatives will be continuing through FY 2006/2007.

Infrastructure Renovation and Replacement Plan

Phase I of the Long Range Infrastructure Plan (LRIP), which incorporates General Fund-related assets, has been in place for some time. During FY 2005/2006, staff worked to identify and inventory utility-related fixed assets. The recommended FY 2006/2007 Budget now includes preliminary estimates on all infrastructure for a full twenty year time frame. Work to refine the utility-related LRIP further will be completed in next year's projects budget process.

Strategic Planning for Affordable Housing

Sunnyvale has several sources of funds for affordable housing, including Housing Mitigation Funds, HOME grants, and Community Development Block Grants (CDBG). With the impending redevelopment of the Town Center Mall, additional funds from the Redevelopment Agency's Low and Moderate Income Housing Fund will become available in the second ten years of the Long Term Financial Plan. In FY 2005/2006, staff began a strategic planning process in order to maximize and leverage the funding for this important community need.

However, more remains to be done. Over the past two years, the City has received very few applications from non-profit housing developers for use of these funds, despite promotional efforts on the part of our Housing Division staff. This is largely due to the fact that non-profit agencies have been unable to outbid private developers for available housing development sites, given the unusually strong market for construction of new for-sale market-rate housing. Although the continuing increase in interest rates is likely to moderate this pressure to some extent, staff believes that we must reconsider our present methods for promoting affordable housing construction and allocating monies in the Housing Fund.

Over the coming year we will evaluate alternative approaches for utilizing our available funds to promote development and preservation of affordable housing. We will seek input from non-profit housing developers through focus groups. Our intent is to develop a strategy for utilizing available funds most cost-effectively before adoption of the Projects Budget for FY 2007/2008.

<u>Update of Planning and Management System (PAMS)</u>

Sunnyvale's Planning and Management System provides the foundation upon which to make informed policy decisions in support of the City's core mission. During this past year, staff completed an ambitious program to update the basic performance budgeting component of PAMS and migrate all City operating programs from the current Outcome Management Budget format to a Performance Based Budget format.

The Outcome Management Budget format was developed in the 1990s as a way to identify and quantify the *value* created from the efficient/effective provision of City services. The focus under this system was on “outcomes”, and marked a shift from the previous emphasis on “outputs.”

Over the last several years, staff has had the opportunity to critically evaluate the Outcome Management system and has identified a number of areas where improvements can be made. Specifically, the Outcome Management system has proved to be too global in its focus, resulting in too great a disconnect between lofty program-level goals and direct activity service provision.

The focus of the conversion was to create a more direct linkage between stated goals and the actual services provided, so that a system of budgeting is created that can be easily understood by the public and that clearly conveys not only how resources are allocated, but what results are being achieved.

At the outset of the conversion process it was determined that all City programs would migrate to the new system at the same time, rather than converting in phases during successive operating cycles. Although a massive undertaking requiring a substantial amount of time and resources to complete, it was expected that a total conversion would help ensure consistency across the City’s many operating programs, result in a more cohesive budget process, and improve the readability of the budget document.

The first step in the restructure process involved examining each department’s organizational structure to identify the major services provided. This step was designed to identify potential gaps in service delivery by analyzing results from resident/user satisfaction surveys, comparing best practices, addressing emerging issues, and responding to direct program management experience. Once all service levels were identified, the next step sought to determine how to measure the success of those services, along with assigning a level of Council priority. Next, the draft program structures were prepared by department directors and program managers, and reviewed by the City Manager for inclusion in the recommended FY 2006/2007 and FY 2007/2008 Budget.

At the February 4, 2006 all day Council Workshop, the preliminary restructured programs, proposed Council priority, and Program Performance Statements and Measures were presented and reviewed by Council. Preliminary Council direction was subsequently incorporated into the recommended Budget document.

The overall result of the restructure process will be an improved system of allocating resources to deliver a defined level of services, an improved system of meaningful success measurement of delivering such services, a system that will provide a clear plan of action for staff to manage the City's day-to-day services, and most importantly, a policy document that can be easily communicated to the community.

General Services Inventory Project

In FY 2005/2006, Finance began an extensive physical assets inventory in partnership with several of the General Services managers. The targeted assets included furniture and equipment managed by the Facilities Services Program, computer hardware, telecommunications equipment, and office equipment managed by the Technology/Application Services Program, and equipment managed by the Department of Public Safety. The goals of the project were to ensure that the City's physical assets related to the General Services Fund are accounted for and to update the existing replacement schedules to accurately reflect the useful life of equipment and its replacement value. The latter will allow staff to adjust rental rates for the FY 2007/2008 Budget to align with updated equipment replacement needs.

With the help of the General Services managers of the targeted areas, Finance began the process of physically identifying and recording information on Facilities, Information Technology, and Department of Public Safety equipment. The initial physical inventory of Information Technology equipment is nearly complete. Results of the inventory indicate that the overall valuation of Information Technology equipment can be reduced due to equipment that will not need to be replaced in the future, longer useful lives, and reduced fair market values. An initial reduction of $500,000 was made on total valuation and the computer hardware replacement schedule was reduced by 20% over two years. During FY 2006/2007, Finance will work with Information Technology staff to finish the review of communications equipment. An updated replacement schedule will also be finalized.

The physical assets inventory of Facilities furniture and equipment, targeted at items greater than $1,000 in value, is complete. The Facilities Services staff has compiled the results and now is working to assign useful lives and replacement values to this equipment. Once that is complete, updated replacement schedules can be created and new rental rates for furniture and equipment can be established for the FY 2007/2008 Budget.

Due to time and resource constraints, the physical assets inventory of the Department of Public Safety equipment was not fully completed in FY 2005/2006. The inventory of Police Services equipment was started and initial results have been recorded. Remaining items for this inventory include finishing the Police Services equipment, conducting an inventory of Fire Services equipment, documenting results, and updating replacement schedules and rental rates as necessary.

Library Facility and Programming

During FY 2005/2006 the Library Department conducted a visioning exercise on Library facilities and services. Results of this study indicated that our Library facility and collection were not keeping up with the growing demand for services and the Library facility is becoming inadequate to support even the current level of services. This effort is moving into the planning phase in FY 2006/2007 and could result in substantial costs to maintain current service levels or new services and facilities.

Closing of Sunnyvale Center for Innovation, Invention, and Ideas (Patent Library)

Since 1963 the City has hosted a Patent and Trademark Depository Library (PTDL) through the Sunnyvale Library. In 1994 the City partnered with the United States Patent and Trademark Office (USPTO) to deliver enhanced intellectual property services on a cost recovery basis. This facility was known as the Sunnyvale Center for Innovation, Invention, and Ideas. Over the years, it has been a challenge to operate the partnership and recover costs, and an increasing General Fund subsidy has been required. In May 2004, Council gave preliminary direction to cease the subsidy of the program and seek an alternative location for its operation. This effort has not been successful to date, and in March 2006 Council approved staff's recommendation to phase out the partnership and return to a PTDL status. This transition will be completed by the end of FY 2005/2006.

Fee Analysis

The Fiscal Sub-element of the City guides staff to set fees for services to recover cost where possible and legally allowed. During FY 2005/2006, all fees that were legally limited were analyzed in detail to ensure the City is setting fees in accordance with the legal requirements.

Additionally, City staff made great progress on a comprehensive initiative focused on ensuring that fees not legally limited, or limited by Council policy, provide full cost recovery for the services that are being delivered. A detailed subsidy analysis was conducted of development fees, which reside largely in the Public Works and Community Development Departments. Department of Public Safety Fees and utility related fees were reviewed and increased to meet projected costs.

The results of these efforts have been incorporated into the recommended Fee Schedule for FY 2006/2007. In some cases, staff found that there were areas where full costs were not being recovered, only direct costs. Where complete data was available to justify the full costing of a fee, adjustments were made. During FY 2006/2007, staff will continue the concentrated effort of closely examining activities, their associated direct and indirect costs, and their related revenues. Results will be reported in the FY 2007/2008 Annual Review of Fees Report to Council.

Year-end Results for FY 2003/2004 and FY 2004/2005

The year-end results for the past two years yielded a positive financial impact for the City. While the positive results were primarily due to one-time revenues and expenditure savings, they did assist the City in regaining financial stability in the short term. For FY 2003/2004, the City's General Fund ended the year in a better financial position from that estimated in the May 2004 revised budget by approximately $4.8 million. In May, we had anticipated drawing down on the reserves about $13.5 million for FY 2003/2004, while actual results were a draw down of $8.7 million. For FY 2004/2005, the General Fund again ended the fiscal year in a better financial position than anticipated in the May 2005 revised budget by approximately $6.5 million. Revenues were higher than estimated by $5.1 million and expenditures were less than budgeted by $1.4 million. This meant that the General Fund drew down much less than anticipated on its *20-year Resource Allocation Plan Reserve*, by $2.7 million rather than the $9.2 million projected. Additionally, during the year-end carryover process, staff recommended that Park Dedication Funds be utilized for Parks-related capital and infrastructure projects to relieve the General Fund of approximately $1.9 million in costs.

New Initiatives for FY 2006/2007

During this year's budget process, several key initiatives were identified that staff is proposing to address during the coming year. These initiatives include Traffic and Transportation Funding, Neighborhood Parks Planning, and a review of the adequacy of City administrative facilities.

Traffic and Transportation needs for the short and long term have been identified through the Transportation Strategic Planning process undertaken by the Public Works Department. With the increased funding for Traffic and Transportation that appears to be on the horizon at the State and Federal level, the City will have an opportunity to take a comprehensive look at our needs and how they best match with available funds. This initiative will be conducted as part of the projects budget process in FY 2006/2007.

One of the most significant challenges facing the parks and recreation profession in urban environments today is that of trying to satisfy a seemingly unlimited demand for a very limited amount of open space. This has been at the heart of several controversial policy issues in Sunnyvale, including cricket play at Ortega Park, a park use and capacity study issue, dogs on/off leash, turf wars among and between youth sports groups for fields, and concerns regarding busloads of children accessing "neighborhood" playgrounds. As the City's population increases and demographics change, additional open spaces and/or changes to existing open spaces may be necessary. Now that the Open Space Sub-element of the General Plan has been completed, an overall review of all parks and open space assets can be undertaken to ensure that the City is maximizing its resources for community benefit.

Finally, it has become increasingly apparent that an analysis of the City's Civic Center complex and Corporation Yard needs to be conducted in light of deterioration and functional obsolescence of the facilities. Funds have been programmed in the Infrastructure Renovation and Replacement Fund for rehabilitation of various components of these buildings. Review during FY 2006/2007 will center around whether to rebuild or rehabilitate our administrative facilities and when this effort should be scheduled.

Continuing Fiscal Pressures and Challenges

During this year's budget process, six additional items were identified that have not been funded in the recommended FY 2006/2007 Budget.

The first of these is the Base Realignment and Closure process for the Onizuka Air Force Station (AFS). Onizuka AFS has been slated for closure by the Department of Defense (DOD) with its military mission transferring to Vandenberg Air Force Base. The Sunnyvale City Council has been formally recognized by DOD as the Local Reuse Authority (LRA) for Onizuka AFS. While closure of Onizuka AFS presents a significant opportunity for Sunnyvale's community and economic development, the reuse planning process will require substantial additional resources.

Sunnyvale is currently funding the Base Realignment and Closure (BRAC) pre-planning efforts with the remaining balance of the California National Emergency Grant for BRAC secured by staff in July 2005 in the amount of $100,000. This grant is set to expire on June 30, 2006 unless the expiration date is otherwise modified. As of February 20, 2006, the grant had approximately $74,000 remaining. Staff anticipates a detailed Onizuka AFS BRAC capital improvement project, and a budget modification will be prepared for Council consideration as soon as specific project cost estimates and grant funding information are available. This is estimated to be in summer 2006.

The second fiscal challenge that has been identified concerns the City's roadway maintenance program. Sunnyvale has maintained the high quality of its street surface in an economical manner by maximizing the use of preventive maintenance methods to minimize the need for more expensive reconstruction or overlay. Budget cuts implemented in FY 2003/2004 caused a downward adjustment of the program's preventive maintenance efforts and these have been further impacted by the increased market pricing for petroleum-based materials such as asphalt and oil. The FY 2006/2007 Budget was developed by holding the amount budgeted for construction materials to the FY 2004/2005 actual expenditure level. Staff is concerned that further increases in oil prices will impact the level of preventive maintenance and cause a reduction in the City's overall Pavement Condition Indicator. Staff will be reviewing this situation during FY 2006/2007 and will bring a report with options for Council consideration.

The third fiscal pressure and challenge is the continuing rise in the costs of labor, both in salaries and benefits. The recommended FY 2006/2007 Budget includes the increased costs for retirement, medical insurance, and other known adjustments related to the Memorandums of Understanding (MOUs) with our employee associations/unions. However, the MOU with the Sunnyvale Public Safety Officers Association will expire on June 30, 2006 and negotiations are underway. Any fiscal impact from the new MOU has not been anticipated in this recommended FY 2006/2007 Budget. Further, if any of the adjustments assumed for salaries and benefits do not hold, the recommended budget does not have the flexibility to handle unplanned increases.

The fourth issue concerns the City's golf operations which are relied upon to support the Community Recreation Fund. Over the past several years golf play has been in decline following national trends; and at the same time several new golf courses have opened in the area that are competing for golfers who otherwise may play in Sunnyvale. In addition, the Sunnyvale Course is older (it currently requires $2.4 million in capital infrastructure improvements over the next ten years) so it is imperative that staff take a new look at the service side of golf operations along with the financial side. Over the next year staff will be developing a vision for the Sunnyvale Golf Course. In developing that vision staff will consider the type of customer it aims to attract and the necessary improvements in food services and golf shop operations that will be required to meet the customers' expectations. Finally, the plan will identify the resources it will take to meet the vision's goals.

The fifth issue identified is Sunnyvale's Water Pollution Control Plant (Plant). The Plant is a fifty year old facility; many components of the Plant have reached the end of their useful life and are in need of major rehabilitation. Over the next 10 years, there are budgeted Plant improvement projects amounting to approximately $34.5 million. However a recent study of the Plant indicates that approximately $55-65 million is needed in the next decade alone for the timely replacement of Plant facilities. This indicates a potential shortfall of $20.5-$30.5 million over the next ten years for Plant improvements.

The cost estimates developed in the study are for replacement in kind of existing facilities. There may be opportunities to reduce the funding shortfall by identifying whether existing processes can be modified so that facilities can be replaced by less expensive alternatives. The cost reduction may be achieved by either a lower capital cost or by constructing new facilities that will result in a reduction in ongoing Plant operation costs. An analysis on the size and capability of the plant will also be done in order to determine what the future needs are before undergo rehabilitation or replacement of the existing plant.

The last issue concerns maintenance of the 100 block of Murphy Avenue. An enhanced level of maintenance service for that block has been carried out as a capital project for the last several years. In December 2005 Council acted to continue the maintenance at an annualized level of $35,000 through June 30, 2006. The direction also asked staff to work with the Sunnyvale Downtown Association to determine options for funding enhanced street maintenance after June 30, 2006 through a parking maintenance district or business improvement district. As of now, a plan for funding the enhanced maintenance has not been approved or implemented and no additional funding is included in the recommended FY 2006/2007 Budget. Council needs to decide whether City funds should be used to continue funding this enhanced level of service or suggest to the Sunnyvale Downtown Association that if this higher level of service is desirable, they will need to pay for this enhanced service.

Conclusion

After several years of severe fiscal crises and challenges, I am pleased to say we finally have a budget that offers optimism. We should be thankful that Sunnyvale's planning and financial management systems provide the foundation on which we have built the solutions to the City's long term financial stability. Without this foundation, the City would find itself unprepared to respond to new fiscal realities. These systems have given us the time and the process for dealing with fiscal challenges in a measured and thoughtful way.

While we can take a breather regarding our long term financial condition, given that the recommended FY 2006/2007 Budget is balanced and the General Fund structural gap that previously existed has been closed, the job is not over. A number of fiscal pressures have been identified that must be addressed in the coming years. Our economic condition continues to be evolving, and we will need to continue to pay close attention and make course corrections as necessary. Most of all, we will have to make courageous fiscal decisions while remaining responsive to community needs.

The City's approach to budgeting and long-term financial planning is complex and highly valued in this organization and in our community. In preparing the recommended FY 2006/2007 Budget and Twenty-Year Resource Allocation Plan, I am fortunate to have had the support and assistance of exceptional staff who continually go beyond the call of duty.

The budget would not have been prepared without the talented and dedicated budget team led by Mary Bradley, Director of Finance and Grace Kim, Finance Manager. These team members, including Drew Corbett, Kurtis Mock, Charlene Sun and Tim Kirby, did a yeoman's job in putting the budget together and I greatly appreciate their dedication. My appreciation also goes to Assistant City Manager Robert Walker, who provided able assistance at every step of the budget process. Last but not least, all the Department Directors and their staff must be recognized for their support and tireless efforts in both the budget restructure process and the preparation of this two-year operating budget.

Finally, I would like to thank the Council for your leadership and commitment in long range financial planning. Your belief in Sunnyvale's Planning and Management System sets the tone for where we need to go as an organization. As a result, Sunnyvale is able to continue delivering the highest quality service at the lowest possible cost, ensuring the quality of life that the community has enjoyed and continues to expect.

Respectfully Submitted,

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Amy Chan
City Manager

May 9, 2006

FISCAL YEAR 2006/2007 BUDGET

OVERVIEW

I am pleased to present a balanced budget for this upcoming fiscal year and the Twenty-Year Resource Allocation Plan. Table I, below, is a summary of the recommended expenditures for all City funds. This table provides a comparison of the recommended FY 2006/2007 and FY 2007/2008 Budget with the revised FY 2005/2006 Budget and the actual expenditures for FY 2004/2005.

Table I Recommended Expenditures – Citywide [1]

Expenditure	2004/05 Actual	2005/06 Revised Budget	2006/07 Recomm. Budget	% Growth 2006/07 over 2005/06	2007/08 Recomm. Budget	% Growth 2007/08 over 2006/07
Operating	155,188,930	167,373,345	173,333,549	3.56%	175,907,735	1.49%
Budget Supplements			3,318,840		4,671,615	
Projects [2]	17,318,316	14,905,984	19,776,633	32.68%	14,730,668	-25.51%
Project Carryovers		50,525,974				
Project Administration	1,845,684	1,327,237	1,637,066	23.34%	1,645,230	0.50%
Equipment[3]	83	300,000	100,000	-66.67%	0	
Lease Payments [4]	2,241,374	1,840,908	1,847,721	0.37%	1,864,638	0.92%
SMaRT Station Expenses [5]	17,163,615	18,057,555	18,836,646	4.31%	19,463,479	3.33%
Debt Service	6,827,930	6,793,371	6,955,010	2.38%	6,911,418	-0.63%
Service Level Set-Aside			500,000		510,000	2.00%
SUB-TOTAL	**200,585,932**	**261,124,374**	**226,305,465**	**-13.33%**	**225,704,783**	**-0.27%**
Employment Development Grant Programs	11,974,834	11,930,000	11,139,630	-6.63%	0	-100.00%
TOTAL	**212,560,766**	**273,054,374**	**237,445,095**	**-13.04%**	**225,704,783**	**-4.94%**

(1) This table excludes internal service funds, which are reflected as rental and additive rates in Operating Expenditures.
(2) Projects exclude General Services projects.
(3) The FY 2005/2006 appropriation for General Fund Equipment expenditure is $300,000, of which $100,000 is expected to be expended in FY 2005/2006 and the remaining $200,000 will be carried over to FY 2006/2007.
(4) Lease Payments include the Parking Lease, SMaRT Station Long Term Lease and WPCP Rent.
(5) The SMaRT Station Expenses represent Mountain View and Palo Alto's shares of SMaRT Station expenses. Sunnyvale's share of expenses is represented in the Operating expenditure line.

The overall recommended FY 2006/2007 Budget is 13.04% below the revised FY 2005/2006 Budget. However, the inclusion of the Employment Development Grant programs and project-related expenditures can be misleading when making year-to-year comparisons.

The recommended FY 2006/2007 Budget for operating-related expenditures is 3.56% higher than the revised FY 2005/2006 Budget. The individual components of the increases vary for each fund and will be discussed in the *Detailed Fund Reviews* section of this Transmittal Letter. However, this overall increase is reduced to 2.6% when the operating expenses for the Water Supply and Distribution Fund are excluded. Due to the significant increase in the cost of purchased water, the FY 2006/2007 Budget for the Water Supply and Distribution operations is 14% higher than the revised FY 2005/2006 Budget. Details of this cost increase will be discussed in the *Detailed Fund Reviews/Water Supply and Distribution Fund* section of this Transmittal Letter

The recommended FY 2006/2007 Budget for projects is approximately $19.8 million, or 32.68% higher than the revised FY 2005/2006 Budget, excluding project carryovers. Each year, the City carryover funds for projects that were budgeted in earlier years but not yet completed. Because projects are often multi-year in nature, project funds are carried over from year to year. This can be seen in the FY 2005/2006 revised Budget number of $50.5 million for project carryovers.

OVERVIEW OF GENERAL FUND AND GAS TAX FUND

Table II on the next page outlines the recommended expenditures for the General Fund and Gas Tax Fund combined. Although these are separate funds, they are added together in Table II to better represent the proposed changes from one year to the next. It is in the interest of the City to expend Gas Tax Funds for eligible projects and operating activities before utilizing General Fund money. This results in increases and decreases from year to year regarding the amount of road maintenance operations that are funded by the Gas Tax Fund and General Fund respectively. By combining the two funds, a clearer picture results as to the year-to-year changes.

Table II Recommended Expenditures – General Fund and Gas Tax Fund Combined							
Expenditure Character	**2004/05 Actual**	**2005/06 Revised Budget**	**2006/07 Recomm. Budget**	**% Growth 2006/07 over 2005/06**	**2007/08 Recomm. Budget**	**% Growth 2007/08 over 2005/06**
Operating	98,036,077	107,566,796	111,130,206	3.31%	113,628,697	2.25%
Supplements			3,318,840		4,671,615	
Project Operating	0	0	22,791		36,476	
Projects [1]	2,782,985	1,404,499	759,216	-45.94%	402,035	-47.05%
Project Carryover		1,848,357				
Debt Service	411,323	410,138	412,778	0.64%	408,969	-0.92%
Lease Payments	1,212,208	1,210,558	1,212,920	0.20%	1,213,805	0.07%
Equipment [2]	83	300,000	100,000		0	
Svc Level Set-Aside			500,000		510,000	2.00%
TOTAL	**102,442,676**	**112,740,348**	**117,456,751**	**4.18%**	**120,871,597**	**2.91%**

(1) *Projects includes project costs and project administration costs.*
(2) *The FY 2005/2006 appropriation for General Fund Equipment expenditure is $300,000, of which $100,000 is expected to be expended in FY 2005/06 and the remaining $200,000 will be carried over to FY 2006/2007.*

As Table II indicates, the overall combined recommended expenditures of the General Fund and Gas Tax Fund for FY 2006/2007 are 4.18% above the revised FY 2005/2006 Budget. Because certain aspects of the budget can change dramatically from year to year, notably capital, infrastructure and special projects, a more precise understanding of the comparative budget is in the operating area. The operating portion of the recommended FY 2006/2007 Budget is 3.31% above the revised FY 2005/2006 Budget.

The major components of changes in the General Fund and Gas Tax Fund operating budgets will be discussed in the *Detailed Fund Reviews* section of the Transmittal Letter.

SERVICE LEVEL CHANGES

As noted in Tables I and II above, a number of budget supplements are being recommended for funding in FY 2006/2007.

Budget Supplements

Budget supplements are called out separately in the recommended budget to draw a distinction between the service levels provided in the baseline budget and recommended expansion or reduction of service levels. Budget supplements originate from two sources. First, Council considers Budget Issues during its Fiscal Issues Workshop in January and forwards any that they wish to have the City Manager address during preparation of the budget for the upcoming year. Second, supplements can be presented to the City Manager by staff during the budget review process based on operational needs. For each budget supplement the City Manager makes a recommendation to Council to either include or not include in the budget. If a supplement is approved by Council as part of the budget adoption in June, that particular activity is moved into the baseline budget and reflected as such in the adopted budget document.

This year, there are twelve budget supplements included in Volume I of the budget document for Council's consideration. Six of these supplements originated as Budget Issues from the Fiscal Issues Workshop in January, one came from the Council review of restructured programs in February, and the others were developed during City Manager review of the departmental budget submittals.

Budget Supplement #1 Liquidambar Street Tree Removal
This budget supplement proposes $50,000 in additional ongoing General Fund funding to allow for an increase in the removal and replacement of approximately forty-two Liquidambar street trees per year. With this increase the total number of Liquidambars removed and replaced by the City will increase to about seventy trees per year. With the current inventory of 3,791 Liquidamber trees, the removal and replacement of all Liquidambar street trees will take fifty-four years if this supplement is approved, as compared to 135 years. The twenty-year impact to the General Fund is a cost increase of $1,253,056 with inflation. The City Manager is recommending this supplement for ongoing funding.

Budget Supplement #2 Identify Sunnyvale - Promote Sunnyvale as a Destination for Shopping, Entertainment, Dining and Lodging
A budget supplement in the amount of $35,000 for one year is requested for the Economic Development Program for FY 2006/2007, funded by the General Fund. The monies will be placed in a new activity to encourage residents and businesses to patronize Sunnyvale companies for entertainment, shopping and lodging. This is a one-time General Fund cost increase and is being recommended by the City Manager. Staff will present the results of the pilot program and request Council direction for future funding support as part of the FY 2007/2008 Budget process.

Budget Supplement #3 Funding for Expanded Neighborhood Grant Program
This supplement proposes to increase the budget for neighborhood grant funds from the current level of $700 to $10,000 with a limit of $1,000 per individual grant. The total cost increase to the General Fund including administration cost is $11,740 for FY 2006/2007. The twenty-year impact to the General Fund is a cost increase of $294,218 with inflation. The City Manager is recommending that this supplement be funded on an on-going basis.

Budget Supplement #4 Proposal to Eliminate the Library's DVD/Videotape Feature Film Rental Fee
This budget supplement requests to eliminate the $1.50 per item fee when users borrow materials from the Sunnyvale Library's DVD/Videotape Feature Film collection. Staff anticipates that this will result in a total reduction of $100,000 in fee revenues per year. A corresponding reduction in the Library's FY 2006/2007 budget is proposed to keep the budget balanced. The reductions are in several Library programs and will not impact the current service levels. If approved, the fee would end June 30, 2006 and the accompanying cut in the Library's budget would take place in FY 2006/2007. There is no net fiscal impact to the City. The revenue and

expenditure reductions included in the supplement are being recommended by the City Manager.

Budget Supplement #5 Case Management for Seniors
The purpose of this budget supplement is to request resources to support a pilot Case Management program for Sunnyvale seniors. Case Management, also known as Care Management, assists seniors and their families in identifying care and service needs. This supplement represents a one-time net cost increase to the Community Recreation Fund of $40,000 for FY 2006/2007 which will require an equal increase in the General Fund subsidy. The supplement is also dependent on a $20,000 contribution from an outside agency to support this program. This supplement is being recommended by the City Manager as a pilot program for one year. If this is a successful program for Sunnyvale seniors, a twenty-year cost of $1,002,445 will be included in next year's budget.

Budget Supplement #6 Alternatives for Street Sweeping Operations
For many years all City streets were swept every other week, but as part of the cost-saving service level reductions implemented in FY 2003/2004, the frequency of street sweeping was reduced to once per month for residential areas. This budget supplement considers options to modify the frequency of street sweeping. Three options are proposed with varying cost increases depending upon the sweeping frequency. Alternative A ($315,804 in annual cost increase) would return to the previous sweeping frequency of every-other-week year round. Alternative B ($260,448 in annual cost increase) would increase street sweeping from the current once monthly by approximately 50%, specifically during the winter (leaf drop and inclement weather time). Alternative C ($246,252 in annual cost increase) would provide some savings by sweeping less frequently in the summer (i.e. no sweeping for 5 months), but returning sweeping during the fall and winter seasons (leaf-drop and inclement weather) to the previous level of service of every other week.

The twenty-year cost increase for each of the Alternatives is as follows: Alternative A - $8,765,372 with inflation, Alternative B - $7,228,926 with inflation, Alternative C - $6,834,911 with inflation. Given budget priorities and the relatively small impact additional sweeping has on street cleanliness, the City Manager is not recommending any of the alternatives for funding.

Budget Supplement #7 Construct Restrooms Building at San Antonio Park
This budget supplement would provide the design, construction and maintenance of a restrooms building at San Antonio Park. The design and construction cost is estimated at $278,000 for FY 2006/2007, which can be funded from the Park Dedication Fund. Annual contributions for infrastructure are $3,333 plus inflation. These can also be supported by the Park Dedication Fund. Additional operations and maintenance cost is approximately $20,000 per year, which is a cost to the General Fund of $531,108 over the twenty-year plan. The twenty-year impact to the Park Dedication Fund is $356,624 for initial capital and infrastructure contributions. The total twenty-year cost for this budget supplement in both Funds is $887,732. This supplement is not recommended by the City Manager for funding.

Budget Supplement #8 Reduction of Service Levels within Program 216 – Roadside and Median Landscape Services
This budget supplement proposes to reduce two quality measure targets for litter and weed removal from 75% to 50%. This is based on a Council request made at the February 4, 2006 Council Workshop on the proposed FY 2006/2007 Budget restructures. Approval of this Supplement would result in a cost saving to the General Fund of $36,898 for FY 2006/2007. The 20-year impact to the General Fund is a cost savings of $1,008,556 with inflation. The City Manager is recommending this supplement for approval and corresponding budget reduction.

Budget Supplement #9 Public Safety Enhanced Parking Enforcement in Downtown
This budget supplement proposes funding for two part-time Parking Enforcement Officers. This is expected to yield no net impact to the General Fund, as the cost of two part-time Parking Enforcement Officers is anticipated to be fully recovered via revenues that are collected from the additional parking citations issued. The total estimated annual revenue attributed to citations issued by the two part-time Parking Enforcement Officers is $96,914. The City Manager is recommending this supplement for inclusion in the FY 2006/2007 Budget.

Budget Supplement #10 Funding for the Recruitment, Selection, and Training of Public Safety Officers
This budget supplement proposes moving the majority of the funding for the recruitment, selection, and training of new public safety officers from the operating budget to a series of recurring Special Projects. This will allow expenditures to fluctuate each year based on the number of recruitments and allow for better monitoring and tracking of expenditures. The fixed costs associated with this activity would remain in the operating budget. For FY 2006/2007, the Department of Public Safety is requesting a total of $3,887,530 to fund recruitment, selection, and training. This consists of $3,222,084 for three Special Projects to hire 21 officers and $665,446 in fixed operating costs. The current budget included $2,341,379 for FY 2006/2007, resulting in a net fiscal impact of $1,546,151. The estimated cost over the next twenty years for recruitment, selection, hiring, and training of Public Safety Officers is a total of $94 million. This includes $79 million in special project costs and $15 million in operating costs. Accounting for the current funding included in the adopted FY 2005/2006 Budget of $63 million, the total twenty-year fiscal impact is $31 million. This funding provides for 266 recruits, yielding 221 successful hires, over the twenty years. The City Manager is recommending that this supplement be approved.

Budget Supplement #11 Request for Email Subscription Management Application
The Information Technology Department (IT) is requesting a budget supplement for the implementation and ongoing maintenance and support of a vendor-hosted automated web-based application that uses email to notify citizens about specific topics of interest when the City's website is updated. The cost to purchase the software is $20,000. Purchase of the software is scheduled for FY 2007/2008 to allow completion of the IT System Infrastructure Audit and Optimal Staffing Study first. The annual operations and maintenance cost is approximately $22,000. The 20-year impact to the General Services Fund/Technology and Communication Services Sub-Fund is a cost increase of $579,070 with inflation. The City Manager is recommending this

supplement for funding in FY 2007/2008 pending the results of the Study of the Information Technology Department in FY 2006/2007.

Budget Supplement #12 Community Recreation Fund Budget Imbalance
This budget supplement addresses the structural budget imbalance of the Community Recreation Fund. As of January 30, 2006, the projected imbalance in the Community Recreation Fund was $650,000 beginning in FY 2006/2007. At the January 30, 2006 Fiscal Issues Workshop, staff presented Council with approximately $413,000 in fiscal strategies including new revenue generation strategies, increased fees, and service level cost efficiencies, designed to reduce the structural budget imbalance. Staff was directed to implement these strategies in the FY 2006/2007 Recommended Budget. Since that time, staff has learned that one of the strategies, funding the *Fun on the Run* program with CDBG funds, was not able to be implemented, thus reducing the net improvement to the Community Recreation Fund fiscal imbalance. Overall fiscal strategies for FY 2006/2007 considering the *Fun on the Run* program impact and increased golf revenue projections amount to $350,000. The other strategies have been implemented or are in the process of being implemented for FY 2006/2007. Staff has also compiled a list of potential additional fiscal strategies to further improve the financial situation of the Community Recreation Fund by up to $1.4 million annually, including the strategies that have already been implemented. However, a large portion of this amount, approximately $900,000, would require reduction or elimination of recreation programs in order to allow for staff reductions.

Service Level Modifications/Enhancements Since FY 2003/2004

As a response to the City's ongoing fiscal crisis, the recommended FY 2003/2004 Budget included a series of service reductions and revenue enhancements to close a projected $15 million structural gap in the General Fund. The service reductions that were implemented are continued in the recommended FY 2006/2007 Budget with some exceptions which have been restored by previous Council action. These are reflected below. In addition, if the list of budget supplements as recommended by the City Manager is approved by the Council, staff believes the Sunnyvale community will be getting a level of service that truly reflects current priority needs and goes a long way to improving the quality of life in our community.

- **Ornamental Water Features in Parks**: Water features at Serra, Braly, and Las Palmas Parks were partially restored to operate from June through September instead of complete closure as originally planned. The cost of this restoration was $24,745 annually.
- **Vice/Narcotics Unit in Public Safety**: Three positions in the Vice/Narcotics unit at the Department of Public Safety were reduced with the remaining staff member assigned to a regional team. In FY 2004/2005 the positions were restored at a cost of $373,366 annually.
- **Sewer Lateral Service in Public Works**: In FY 2004/2005 Council appropriated $64,694 to restore service to maintain, repair, and replace private sewer laterals, and install clean-outs on private sewer laterals. This service is operated in the Wastewater Management Fund.
- **FY 2004/2005 Service and Budget Reduction Package**: A budget reduction package totaling about $1 million was approved as part of the Adopted

FY 2004/2005 Budget but deferred until January 2005. Subsequently the reduction package was deferred again until July 1, 2005. The reductions were addressed again as part of the FY 2005/2006 Budget and were not recommended by the City Manager for implementation.

In the interim since FY 2003/2004 several other services have been added or enhanced in the Community Recreation Fund. A full discussion of these is contained in the *Community Recreation Fund* section of this Transmittal Letter.

BUDGETARY INFLATION FACTOR

Inflation of purchased goods and services for the recommended Twenty-Year Resource Allocation Plan is assumed to be 1.5% for FY 2006/2007, 2% per year for the remainder of the first ten years, and 3% for the second ten years. Certain selected budget components, such as purchased water, gasoline, or electricity are increased (or decreased) according to their individual cost characteristics.

Salary increases are based on current memoranda of understanding (MOUs) with employee associations, which provide for annual review of each respective salary formula. Because the increases are dependent on labor market conditions, they do not follow any predictable inflationary pattern.

Projections for major revenues are based on detailed analyses of their unique characteristics and therefore they do not necessarily reflect a simple inflation pattern. The assumptions for each major revenue source will be detailed in the discussions of each appropriate fund. To the degree possible, all fees are based on the full cost of service.

The budgetary inflation assumptions mentioned above are particularly significant since the City utilizes multi-year financial planning over a twenty-year period. Small changes can have a significant long-term effect. For example, a $1 million loss in revenue or a $1 million increase in operating expenses in an assumed 3% inflation environment amounts to a cumulative $26.87 million change in position over the entire planning period.

OVERVIEW OF PROPOSED CAPITAL AND SPECIAL PROJECTS BUDGET

In keeping with the separation of the operating and project budget cycles, FY 2006/2007 is the second year of a two-year capital and special projects budget. For this submittal, project scope or cost was updated as necessary and a small number of new projects were proposed. As a result of the project budget process this year, I am recommending $19,776,633 in capital and special projects in FY 2006/2007 and a total of $238,002,339 in projects over the twenty-year planning period. Most of the projects proposed are possible because of special funding available for areas such as streets, transportation, and parks. Major capital and infrastructure efforts are also underway in the Water and Wastewater Utilities. It is important to note that the City also has unfunded capital improvement projects, totaling $433 million over twenty years, as identified in last year's budget. Strategies to fund these projects will need to be developed as part of next year's Projects Budget review.

Details of the projects budget are included in the *Major Project Efforts* section of this Transmittal Letter, in discussion of the individual funds, and in *Volume III Projects Budget* of the budget document.

Table III below contains project appropriations by fund for FY 2006/2007 and the remainder of the long term planning period.

Table III Project Expenditures by Fund

Fund	**2006/2007 Recommended Budget**	**2006/2007 to 2015/2016 Total**	**2016/2017 to 2025/2026 Total**
Asset Forfeiture	82,000	614,758	692,795
Capital Projects	1,613,045	8,921,323	11,660,697
Community Development Block Grant	2,693,763	5,769,561	2,205,417
Community Recreation	19,359	49,755	0
Gas Tax	82,148	281,143	282,538
General Fund	598,229	3,462,841	3,114,185
Housing	2,084,819	4,980,231	0
Infrastructure Renovation & Replacement	2,014,530	24,534,830	27,676,772
Park Dedication	218,980	3,420,054	19,695
Parking District	7,500	125,000	125,000
Redevelopment Agency	1,260,000	1,460,677	71,378
SMaRT Station*	4,751,772	7,649,721	10,808,717
Utilities	4,350,488	73,189,055	46,886,195
TOTAL**	**19,776,633**	**134,458,949**	**103,543,391**

* The SMaRT Station project costs represent Mountain View and Palo Alto's share. Sunnyvale's share is included in the Utilities project cost.
** Total excludes General Services Fund projects.

FUTURE FISCAL ISSUES

Midway through each fiscal year, a Council Study Session is held that identifies factors in the City's current environment and in the near-term that could impact our fiscal security. This year, the Study Session was held on January 30, 2006. The purpose of the Study Session was to:

- Provide Council with an update on regional and statewide economic conditions
- Identify the possible effect of the proposed FY 2006/2007 State budget on Sunnyvale
- Identify and briefly discuss City budgetary challenges and opportunities
- Report the effect of year-end results for FY 2005/2006 on the City's long term financial plans; and
- Discuss proposed budget issues and receive initial policy direction as to whether to direct the City Manager to consider them in preparing the recommended FY 2006/2007 Budget.

Below are discussions of the major areas covered in the Fiscal Issues Study Session.

CURRENT ECONOMIC CONDITIONS AND OUTLOOK

The steep economic downturn that so severely impacted the City's fiscal condition over the last several years has given way to a moderate recovery, led by gains in consumer spending, large increases in business investment, and an extremely active housing market. Economic growth is projected to continue into next year. However, there are a number of downside risks that could pose serious threats to the economy and its recovery.

While the economic recovery in the Bay Area lagged significantly behind the state and nation over the past several years, the economic outlook is finally improving, with job gains expected in 2006. Such gains should support continued moderate growth in taxable sales coming on the heels of nine consecutive quarters of year-over-year declines. This recovery is currently reflected in a marked increase in Sunnyvale's receipts of Sales Tax and Transient Occupancy Tax so far this year.

National Economy

The national economy continued to experience solid economic growth, but the growth rate is expected to moderate over the next few years. Gross domestic product (GDP), the measure of total goods and services production in the country, experienced an annual 3.8% growth rate in 2005.

Current economic projections are that the U.S. economy will expand at a solid though moderating pace in 2006, with economic growth as measured by the GDP, projected to be 3.7% in 2006 and 3.3% through 2010. Forecasts assume that business investment will continue to increase but the growth in consumer spending will slow.

Since the collapse from the euphoric "dot.com" era, consumer spending and residential investment have been the predominant drivers of the nation's economy. Consumer spending, which fueled about two-thirds of U.S. economic activity since the downturn, was buoyed by low interest rates. Beginning with the economic downturn in 2001, the Federal Reserve reduced interest rates to stimulate investment and increased spending. Consumers took advantage of historically low mortgage rates to either enter the real estate market or to refinance existing loans and use the funds for discretionary spending. However, the Federal Reserve has increased its short-term interest rate 15 times since June 2004 and signaled that it will keep raising this benchmark rate in the coming months to prevent inflation from rising. Meanwhile, higher energy costs are leaving consumers with less money to spend on other goods and services. The current increases in interest rates and in energy prices are forecast to have a dampening effect on consumer spending in the coming months.

An important element of the current recovery is business investment. The continued rebound in business investment played a big role in the strong expansion of the national economy in 2004 and 2005. Business investment has led to an increase in taxable earnings and in business-to-business spending. Job gains are also projected to exceed 2005 levels. However, there are a variety of different factors that may hinder future growth in business investment for 2006. These mainly include rising energy costs, interest rate hikes and a slowdown in the residential real estate market.

Finally, macro-economic issues, such as geo-political uncertainties, the Nation's increasing trade deficit, and the growing federal budget deficit all represent risks to future economic growth over the later years of the planning period.

The California Economy

The California economy strengthened along with the national economy in 2005. Factors boosting economic growth over the past year have included the strong national rebound in business investment, the state's booming housing market, and increased spending on high-tech equipment, which is especially good for the local economy.

Economists project that California's economic growth will continue in 2006, although at a more moderate pace than in 2005. On the positive side, the national outlook for continued strong business investment will boost manufacturing and technology in the state. However, the same negative forces that will have a dampening impact on the national economy, such as high energy costs and rising interest rates, will affect consumer spending and housing activity in the state.

The Bay Area Economy

While both the national and state economies stabilized in 2004, economic growth in the Bay Area lagged behind, particularly in the Silicon Valley. Evidence in the form of our own Sales Tax and Transient Occupancy Tax receipts indicated that our area reached the bottom and began a slow recovery in the third quarter of 2004 and throughout 2005. However, employment and the commercial real estate market still remained extremely problematic in 2005, and the recovery in the Bay Area has largely been "jobless." The local economic outlook is finally improving, however, with job gains experienced for the first time in 2006. These gains are expected to support continued moderate growth in taxable sales. Other factors leading to this forecast include an increase in real income, higher business spending and a positive outlook for the commercial real estate market.

Economic Risks

Although the local forecast looks promising, there are a number of factors that could threaten even a moderate expansion of the economy at all levels. Continued increases in energy costs, e.g., gasoline and petroleum-based products, are particularly worrisome. The price for crude oil recently hit an all-time high and is expected to remain at or near record levels over the next several months.

Rising interest rates pose another risk factor that could lead to a negative domino effect on the residential housing market, construction and consumer spending, among other things. So far, rising interest rates have not burst the housing bubble, but it is clear that the region is experiencing a slowdown in the residential housing market that needs to be closely monitored going forward.

The Silicon Valley also continues to be plagued by high vacancy rates in commercial and industrial properties. After dipping below 10 million square feet in February 2006 for the first time since 2001, office space for lease in Silicon Valley climbed by approximately 270,000 square feet, or 2.7%, as of April 1, 2006. The worst performing area among major Silicon Valley markets over the last several months has been Sunnyvale, where office space available for lease has recently risen 8.5% to 1,013,649 square feet. This is due in part to Sunnyvale's over abundance of Class B and Class C buildings, which are less desirable than Class A properties. However, office space for rent in Sunnyvale is still down 4.1% over the prior year.

Consensus among economists is that our Bay Area economy will grow, but big problems remain for the region and the state. Challenges include the country and the state slipping deeply into debt, as well as the need for more funds for health care, education, and infrastructure.

Staff has taken the condition of the state and regional economy into consideration in preparing the recommended FY 2006/2007 Budget and long term projections for Council's consideration.

PROPOSED FY 2006/2007 STATE BUDGET

The Governor's Proposed FY 2006/2007 Budget issued in January indicates that revenues for the current year and FY 2006/2007 are projected to be higher than anticipated. Currently, State revenues are up over $4.5 billion more than anticipated in January. However, one major note of caution is that this unexpected increase in revenue is primarily from volatile sources such as business profits and capital gains. Instead of using this one-time revenue for one-time purposes, such as paying down debt or capital improvements, the State budget proposes to increase ongoing spending by approximately $2 billion. This is eerily reminiscent of the late 1990s when the State squandered record budget surpluses, leading to a massive structural budget deficit that the State has not yet entirely eliminated. While this situation needs to be closely monitored, the State budget, as proposed, does not have any major negative impacts to Sunnyvale.

For the first time since 2003, the Governor's budget proposal does not seek to shift additional local funds to the State. This is due in large part to the provisions of Proposition 1A, which constitutionally protects local revenues from State takeaways. Over the past two fiscal years, Sunnyvale has shifted about $4.7 million to the State for education funding ($4.1 million in General Fund property tax and $600,000 in Redevelopment Tax Increment), consistent with the terms of Proposition 1A. This additional funding shift ends in FY 2006/2007.

Also consistent with the terms of Proposition 1A, the State will begin to pay back previously deferred reimbursements for state-mandated costs. When the State mandates that cities provide additional services, they are required by law to reimburse cities for the increased costs. Since FY 2001/2002, the State has deferred approximately $500,000 in reimbursements to Sunnyvale, which will be repaid over 15 years, beginning in FY 2006/2007. Another provision of Proposition 1A required the State to resume mandated cost reimbursements in the current fiscal year that were incurred in FY 2004/2005. To date, we have received $34,000. All of these reimbursements have been anticipated in the long range financial plan.

In the area of transportation funding, the City has yet to receive substantial funding from Proposition 42, the Transportation Congestion Improvement Act. In each fiscal year since its adoption in 2002, the State has suspended the funding of Proposition 42-related programs in order to reduce its General Fund budget deficit. However, in FY 2005/2006 the City received $556,000 from Proposition 42 and may receive substantial repayment amounts for the previously suspended funding beginning in FY 2006/2007. This is discussed in greater detail in the *Traffic and Transportation Funding* section of the Transmittal Letter.

The Governor is also proposing a major capital initiative called the New Strategic Growth Plan, which seeks to improve the State's infrastructure in the areas of transportation, flood control and water supply, public safety and courts, and other public service infrastructure. While the initial plan called for a massive 10-year, $222.6 billion outlay, a smaller proposal is included in the upcoming 2006 fall ballot.

Other elements of the proposed State Budget that have an impact on Sunnyvale include the continuation of Supplemental Law Enforcement Funding, or SLES, which is maintained in the Proposed Budget at the existing level of $192,000. These funds support a patrol captain in the Public Safety Department. The Governor's proposal also includes restoration of the Booking Fee Subvention, newly titled the Local Detention Facility Fund. In years past, the State reimbursed costs paid by Sunnyvale to the County of Santa Clara for the processing of arrestees. The total costs and corresponding revenue from the State, were fixed based on an average number of bookings. The expense and revenue amounted to approximately $180,000 per year. The subvention was eliminated in the current fiscal year with the proviso that counties could only charge cities one-half of direct booking costs. This had a net fiscal impact on the city of $90,000 during the current fiscal year. The County of Santa Clara has now stated that actual booking costs are much higher than previously thought (approximately $360,000 for which Sunnyvale would pay half, or $180,000). Staff is now in the process of reviewing the County's methodology for calculating booking costs to verify actual costs.

While the Governor's proposed FY 2006/2007 Budget is balanced for FY 2006/2007, the State will continue to experience a structural budget imbalance in future years absent ongoing corrective actions. The State's independent Legislative Analyst has indicated that the overall budget plan fails to take advantage of the opportunity to reduce the underlying structural deficit. Should the economy falter, the State's revenues will once again sharply decline.

Other Budgetary Impacts for Cities in May Revise

On May 12, 2006 the Governor will release his May Budget Revision (the "May Revise"). This document updates the underlying revenue assumptions based on tax receipts as of April and contains any changes or "deals" made since July. Staff will be reviewing the May Revise as soon as it is released and will brief Council on its contents and how it impacts our financial condition at the Budget Workshop on May 23.

CITY BUDGET CHALLENGES AND OPPORTUNITIES

At the Fiscal Issues Workshop in January, staff identified a number of challenges that are currently facing the City as well as some opportunities that might be able to assist us in strengthening our financial situation.

The challenges identified are discussed below.

Fuel-Related Costs

Costs for petroleum-based products have risen dramatically over the past year, as seen most clearly in the price of gasoline. These increases affect a number of costs in the City's operating and projects budgets. The City's Fleet Services program is experiencing fuel costs that are approximately 20% higher this current year. These fluctuations are caused by market conditions, including the situation in the Middle East, world demand for fuel, refinery capacity, and natural disasters, such as Hurricane Katrina. The overall cost of energy has also had a significant impact on the cost of automotive parts and supplies, due to manufacturing and transportation costs.

Impacts in the rise of petroleum costs can also be seen in the street operations area and in capital projects related to street repair and reconstruction, which depend heavily on oil related commodities.

Community Recreation Fund Structural Deficit

As identified in last year's Transmittal Letter, the Community Recreation Fund has continued to experience a structural imbalance between revenues and expenditures. The FY 2005/2006 Long Term Financial Plan for the Community Recreation Fund forecast that a decrease in expenses or an increase in revenues of approximately $650,000 on an ongoing basis would be required to be in balance and without additional subsidy from the General Fund. During this current year, Parks and Recreation Department staff have developed a series of recommendations to close this deficit. These recommendations are discussed more fully in the section of this Transmittal Letter on the Community Recreation Fund and details may be found in Budget Supplement No. 12.

Information Technology Needs

The Department of Information Technology (ITD) provides significant support in the selection, implementation and ongoing maintenance of major technology applications. This support was restricted as a result of the substantial budget reductions that were experienced in FY 2003/2004. In response to similar funding reductions, other City departments identified needed technology solutions for streamlining their operations, but ITD has not been able to meet these needs with existing funding and staffing levels. To address this continuing technology gap, an audit of the City's technology environment and an optimal staffing study of ITD was started in April 2006. It is expected that this study will be completed during FY 2006/2007, and the results will provide strategic direction to meet the short-term and long-term information technology needs of the City.

Unfunded Capital Projects

In FY 2004/2005 City staff began the process of identifying all of the City's capital and infrastructure needs. Those projects that were not the most critical or fully scoped were placed on an unfunded projects list. During the FY 2005/2006 budget process, staff focused on refining the unfunded projects inventory further. This work resulted in a full twenty-year inventory of the City's unfunded projects. A total of $433 million was identified over the twenty-year planning period. A number of these projects are becoming critical, particularly our aging and inadequate public buildings and facilities. As staff begins the projects budget process during FY 2006/2007, funding strategies will be developed to deal with this multimillion dollar liability.

Long Range Infrastructure Plan

Sunnyvale has traditionally provided funding in its operating budgets for optimizing maintenance of City infrastructure. Staff believes this to be the most cost-effective, long term way to approach asset management. Nonetheless, even with this proactive maintenance approach, eventually every infrastructure element reaches a point where maintenance is no longer a cost-effective strategy; and significant renovation and replacement is required. Funding of the renovation and replacement of the City's estimated $1 billion in infrastructure assets is an enormous challenge, but it is critical to the long-term quality of life and financial condition of the City. The City has taken action on several fronts to deal with this challenge. Over the past two years, the City has updated the scope, cost and original assumptions for the General Fund-related assets. Additionally, all utility-related fixed assets have been identified and inventoried, with preliminary estimates for replacement costs and schedules. This effort is discussed in more detail in the *Major Projects Efforts* section of this Transmittal Letter.

Retiree Medical Costs

The Governmental Accounting Standards Board (GASB) has issued Statement No. 45 regarding the accounting and reporting by employers for post employment benefits such as retiree medical costs. The City will have to implement this statement for FY 2007/2008. This will require that we disclose our liability in our financial statements. These disclosures will be closely examined by bond rating agencies and other parties interested in our fiscal condition. Currently, the City uses a pay-as-you-go method for funding retiree medical costs. In our twenty-year financial plan we have fully budgeted for these costs based on certain assumptions. The total budget for retiree medical costs over the twenty-year plan is $150 million. To prepare for the implementation of GASB 45, the City is currently contracting for an updated actuarial study to determine our liability on the new basis. Following the study, we will determine whether there is any additional cost that needs to be budgeted associated with these benefits. There also may be the opportunity to participate in a trust through the California Public Employees Retirement System (CalPERS) or another agency to fund these benefits on an actuarial basis.

Pension Reform

The topic of pension reform has been under intense discussion by the Governor and the State Legislature as a means to combat the State's rising retirement costs and curb perceived excesses. Last year, both the Governor and Assembly Member Richman proposed constitutional amendments that would have limited defined benefit pension plans and converted new employees to defined contribution plans. While the Governor appears to have suspended his pension reform efforts, Assembly Member Richman and others are continuing to work toward a future initiative effort. While there is no immediate impact on the City of any pension reform plans, it is probable that any change would have a long term financial impact on Sunnyvale. In the case of the constitutional amendments which limit retirement plans or the City's portion of the cost, there would presumably be a substantial savings, beginning in the later years of the Long Term Financial Plan.

Threats to Telecommunications Taxes

Within the last several years, a complex array of technological advances has been emerging in the areas of data transmission, Internet access, telecommunications and video (cable) services. The convergence of these industries, each with disparate, multi-level governmental frameworks for taxation purposes, has blurred the lines between what is taxable and non-taxable. It has also necessitated regulatory change that could have far-reaching negative implications for California cities. Depending upon the outcome of anticipated tax reforms, Sunnyvale could see an erosion of revenues associated with cable and telephone services such as Utility Users Tax, Franchise Fees, Sales Tax and 911 Fees and Surcharges, and could lose local control over the ability to negotiate cable franchise agreements.

The current legislative debate, playing out nationally and in state legislatures across the country, centers around whether telecommunications companies need to obtain local cable franchise agreements before providing video services. At the federal level, legislation has been proposed that would permit video service providers (both incumbent cable operators and new entrants such as telephone companies) to obtain a national franchise, allowing them to bypass local governments across the country. Similar legislation has just been unveiled in California, which would grant a statewide franchise to new market entrants.

Sunnyvale receives approximately $1.6 million annually in Utility Users Tax from telephone providers and approximately $1 million in Franchise Fees from cable services. Any major erosion of these revenues as a result of changes in federal or state laws would have a significant negative effect on the General Fund. As Sunnyvale is compensated for the cable provider's use of city-owned rights-of-way and also regulates certain cable services, any significant changes to federal and/or state law governing local franchising authority could put local control at risk.

Three opportunities that the City has been investigating to improve its financial position in the near future were also presented at the January Fiscal Issues Workshop. These include implementation of an Emergency 911 Fee, a review of the City's land banking policies, and the ongoing optimal staffing studies of major City departments. Each of these opportunities is discussed briefly below.

Emergency 911 Access Fee

In June 2004, the City Council approved in concept an Emergency 911 Access Fee to recover the substantial costs of operating the City's emergency 911 dispatch center. The fee was not enacted due to legal issues and challenges faced by a number of cities who had recently established the fee in their jurisdictions.

Two municipalities, Stockton and Union City, as well as the County of Santa Cruz, enacted such ordinances in FY 2003/2004 and are currently involved in lawsuits sponsored by telecommunications providers. The lawsuits essentially allege that the fee is actually a tax and therefore has been enacted in violation of the voter approval requirements of Proposition 218. The lawsuits are still currently in progress, but Union City's fee was recently voided and declared a special tax requiring two-thirds voter approval. It is unknown at this time whether Union City will appeal the decision. On the other hand, a State appeals court recently upheld the County of Santa Cruz fee as an allowable cost recovery mechanism *not* subject to the voter approval requirements of Proposition 218. The lawsuit in Stockton is still pending.

Meanwhile, the City of San Jose began collecting an Emergency 911 Fee in January 2005 and has not had legal challenge as of yet. The San Jose fee is set to expire at the end of this year, but it is expected that reauthorization will be requested. In addition, the County of Santa Cruz and the City of Watsonville withstood citizen initiatives in November 2004 that sought to invalidate their respective fees. Furthermore, the City and County of San Francisco implemented an Emergency 911 Fee in 1993 that has not been challenged.

Based on the uncertain timing and outcome of the existing lawsuits, staff has not brought this cost recovery fee forward for further Council consideration in the recommended FY 2006/2007 Budget. The fee is projected to recover approximately $2.3 million out of $3.2 million in direct dispatching operating costs. Staff will be reviewing the elements in each of the existing ordinances to identify how we can structure our fees to withstand legal challenge. When and if a clear conclusion is reached with either of the ongoing court cases or if our review indicates that we can craft a legally defensible fee, staff will bring forward for Council consideration the implementation of this new revenue to offset the continuing substantial costs of our emergency dispatch center.

Surplus Property and Land Banking Policy

During FY 2004/2005 Council provided preliminary direction to sell excess City land that is not tied to development plans or facility needs. Sale of excess parcels not needed by the City's core operations can generate significant one-time revenues as well as eliminate ongoing maintenance costs. The recommendation in last year's budget was to hold off the disposition of any land pending updates to the City's Open Space and Fiscal Sub-elements. The former has been completed and the latter is underway. These policy documents will assist in decision making regarding the City's land assets in FY 2006/2007.

The recommended FY 2006/2007 Budget includes the disposition of several properties in the General Fund and Park Dedication Fund. In keeping with the financial policies included in the Fiscal Sub-element of the General Plan, it is recommended that the proceeds of these sales be placed into a Reserve for Capital Improvements. More details on the proposed land sales are included in the *General Fund* and *Park Dedication Fund* sections of this Transmittal Letter.

Optimal Staffing Studies

In order to ensure that the City is using its staff resources in the most cost efficient manner, we have embarked on a program of optimal staffing studies by Department since 2004. The first Department was Public Safety. The final report was issued in December 2005 and Public Safety is now preparing a response and implementation plan which is due to the City Manager in June 2006. The next study, of the Department of Public Works, started in December 2005. It is now well underway and we estimate completion by June 2006. The report will then undergo the same process as Public Safety, with a response and implementation plan from the Department to be completed by fall 2006.

Currently, staff is beginning an optimal staffing study of the Information Technology Department. Once the consultant has been selected, staff will be coming to Council for award of contract and a budget modification for the project. It is expected that the study will be completed during FY 2006/2007. In the future, the plan is to perform these studies on every City Department.

YEAR-END RESULTS FOR FY 2005/2006

The Adopted FY 2005/2006 Budget included a structural deficit in the General Fund of $1.1 million for seven years beginning in FY 2006/2007. Additionally, the Community Recreation Fund, which is closely related to the General Fund, had a projected ongoing deficit of $650,000 beginning in FY 2006/2007 and growing throughout the twenty years of the Long Term Financial Plan.

When the City's financial books were closed for FY 2004/2005, the General Fund ended the fiscal year in a better financial position than anticipated in the FY 2005/2006 Long Term Financial Plan by approximately $6.5 million. Revenues were higher than estimated by $5.1 million and expenditures were less than budgeted by $1.4 million. This meant that the General Fund drew down much less than anticipated on its *20-year Resource Allocation Plan Reserve*, by $2.7 million rather than the $9.2 million projected. These results had a positive financial impact for the City, although they were primarily due to one-time revenues and expenditure savings.

Additionally, during the year-end carryover process, staff recommended that Park Dedication Funds be utilized for Parks-related capital and infrastructure projects to relieve the General Fund of approximately $1.9 million in costs.

BUDGET ISSUES FOR CONSIDERATION IN FY 2006/2007

Budget Issues are proposals to add a new service, eliminate a service or change the level of an existing City service. Budget Issues can be proposed by the City Council, Boards and Commissions, or staff. Budget Issues recommended by members of the public must be sponsored by a member of the Council for funding consideration. In prior years, Budget Issues for the upcoming fiscal year were discussed as a part of the Study Issues process. This year, a separate public hearing on the Budget Issues was held on January 30, 2006, to allow for greater participation and input from Council, Boards and Commissions, and members of the public.

Upon conclusion of the public hearing, the Council votes to either send a Budget Issue on to the City Manager for consideration in the recommended Budget, or defer or delete the Issue. Those items that are sent to the City Manager for consideration undergo a more detailed analysis and are presented as Budget Supplements for Council consideration in the upcoming budget process.

For FY 2006/2007, seven Budget Issues were considered at the January 30 public hearing, and all were referred on to the City Manager for consideration. Six are presented in the Recommended Budget as Budget Supplements. Four of the six are recommended by the City Manager for Council approval. They are: Liquidambar Street Tree Removal, Support of Hospitality Industry, New Neighborhood Grant Program, and Case Management for Seniors. The one item not presented by the City Manager as a Budget Supplement is Records Management and Document Imaging System. This item will be brought forward to Council consideration at a later date, pending the results of a needs assessment.

These items are discussed in greater detail in the *Budget Supplement* portion of this document.

FISCAL STRATEGIES

One of the most powerful aspects of multi-year budgeting and projection is the ability to plan for the future. Small changes made now can avert large problems later. A number of fiscal strategies have been identified in the past several years to position the City well so that quality services can be sustained in the years to come. These items generally fall into two categories: General Philosophies and Strategies. The General Philosophies reflected are as follows:

- **Provide the highest quality services at the lowest possible cost**
- **Ensure that we are good stewards of the City's infrastructure assets**
- **Don't sacrifice safety or quality of life**
- **Support diversity in all areas of the community**
- **Build and emphasize the connection between the community and business**
- **Support a quality work force**
- **Emphasize and build on the unique culture of Sunnyvale**
- **Stick to the knitting, focusing on issues that can make a difference**

To support these philosophies, a number of strategies and action items were identified to be explored during FY 2005/2006. Some of these were Citywide, while others related to a particular department or expenditure area. Staff has done a great deal of work on various action items related to these strategies, and these actions have had a positive impact on the City's financial condition.

The strategies that were explored and implemented fell into certain topic areas, or themes, which are worthy of reemphasizing.

Don't Make Matters Worse: This strategy speaks to our emphasis on Demand Management and Long-Term Planning. Action items in this area include:

- Pay close attention to the financial impact of policy decisions made throughout the year
- Think strategically by emphasizing the multi-year effects of key decisions
- Manage the City's "Life Style" so that we can live within our means

Continue to Emphasize Efficiency of Operations: This strategy speaks to Sunnyvale's long established emphasis on continuous improvement. Action items for this strategy are:

- Use cost-effective technologies to increase productivity, enhance customer service and/or reduce the cost of service
- Leverage and partner with community groups, non-profit organizations, and where appropriate the private sector to maintain services and lower costs
- Explore alternative service delivery methods including contracting out
- Work with employee associations to identify ways to more effectively utilize City resources
- Evaluate most effective and efficient organization structure to deliver services
- Manage/contain personnel costs

- Reduce or eliminate reserves that are not needed for prudent financial management

Investigate new and increased revenue sources: This strategy includes the City's existing taxes and fees and any opportunities for new taxes and fees to add to our ongoing revenue base. Action items in this area include:

- Review existing fees to ensure that full cost of the service is being recovered
- Evaluate the current level of the City's existing taxes for opportunities where our taxes are below the area norm
- Identify any new taxes or fees that might be appropriate to consider implementing

Reduce or eliminate services or modify service levels: This strategy focuses on adjusting the City's services and service levels to preserve essential core service but establish the most appropriate level for our fiscal circumstances. The service level review process that Council undertook in preparing the FY 2004/2005 Budget utilized this approach in prioritizing the City's services.

It is recommended that Council and staff continue to focus on these policies and strategies that will help the City maintain its fiscal health and become a more effective, high performing organization.

MAJOR PROJECT EFFORTS

Sunnyvale's projects budget is a complex document involving four separate and distinct categories of projects: capital, infrastructure, special, and outside group funding. The projects themselves are budgeted and accounted for in various funds, most notably the General and Gas Tax Funds, the Capital Projects and Infrastructure Funds, and the Utility Funds.

Major initiatives and actions have added to this complexity. For example, the City's remarkable infrastructure planning and funding efforts led to the creation of long-term projects to fund major renovation and replacement efforts. The City's debt financing strategies are also reflected in this area.

Over the past few years the City enjoyed a number of grants and outside funding sources available for specific project categories, such as parks and streets and transportation. The City successfully utilized revenues such as the Santa Clara County half-cent Sales Tax for transportation (Measure B) and the State Traffic Congestion Relief Program along with State Park Grants (Proposition 12 and Proposition 40) for a number of maintenance and improvement projects. Revenues generated from City-imposed fees such as Traffic Mitigation Fees and Traffic Impact Fees and Park Dedication Fees also have added to the City's ability to address capital needs. For the future, it appears that an increased level of transportation funding from the State and federal governments will be available. More discussion on this issue is contained in the section on *Traffic and Transportation Funding* below.

Along with the new initiatives and funding opportunities, the City also has a number of challenges in the projects area. As was discussed earlier, a major inventory of all funded and unfunded capital and special projects has been underway. This effort identified approximately $433 million in unfunded projects over the twenty-year Capital Improvement Plan. During next year's project budget cycle, staff will be building on this work to completely review our capital and infrastructure programs and revise the estimates as needed. The full impact of the study will be included in the FY 2007/2008 Projects Budget.

The recommended FY 2006/2007 Budget includes funding for a total of 307 projects in all categories over the Twenty-Year Plan. The discussion below focuses on some of the special funding sources and provides information on the status of major project initiatives. Highlights of recommended projects for each fund are included in the *Detailed Fund Reviews* section of this Transmittal Letter.

SPECIAL PARKS FUNDING

Proposition 12 Funds

The passage of the Safe Neighborhood Parks, Clean Water, Clean Air and Coastal Protection Bond Act of 2000 (Proposition 12) provided funds to cities on a per capital basis to be used for various local park and recreational lands and facilities. The City has already programmed all $1.5 million of these funds for a variety of park improvements through FY 2006/2007. This includes funds programmed in FY 2005/2006 for the Park Buildings Rehabilitation project and the Playground Equipment Replacement project in the Infrastructure Fund. The remaining balance of $13,321 is programmed in the Park Buildings Rehabilitation project in FY 2006/2007.

Park Dedication Fees

When developers of multi-family housing do not dedicate land for use as parks, the City collects a fee in lieu of the land dedication. These Park Dedication Fees are then used to pay for park facilities. These fees recently helped to pay for the Fair Oaks Skateboard Park and the first phase of the Plaza del Sol in downtown Sunnyvale. $500,000 of Park Dedication fees have also been programmed for the Sunnyvale Historical Museum which is expected to start construction in the fall of 2006.

The City is currently experiencing a marked increase in new housing developments that are subject to Park Dedication Fees. An additional $11.2 million in fees are projected to be received over the next four years. The recommended FY 2006/2007 Budget reflects the use of these anticipated fees to fund all park-related infrastructure projects in the 20-year planning period through a transfer to the Infrastructure Rehabilitation and Replacement Fund. This strategy relieves the Community Recreation Fund and the General Fund of these essential expenses.

A total of $21.4 million is projected to be transferred to the Infrastructure Rehabilitation and Replacement Fund over the Twenty-Year Financial Plan. Major infrastructure projects to be funded include replacement of the Community Center Building Roofs, Washington Pool Renovation, Golf Course Greens Renewal, Rehabilitation of Parks Buildings, and Golf Course Tee Grounds Renewal.

Additionally, there are two noteworthy park projects recommended to be funded with Park Dedication Funds in the first ten years of the Long Term Financial Plan. The first is $2.2 million for phase II of the Plaza del Sol, which is discussed in more detail in the *Major Projects Efforts* section following. The second is a Park Land Acquisition project in the amount of $1 million in FY 2007/2008.

More detail on the Park Dedication Fund can be found in this Transmittal Letter in the *Detailed Fund Reviews.*

TRAFFIC AND TRANSPORTATION FUNDING

The City has identified a number of needs related to maintaining our existing network of street and road assets and expanding capacity as needed for future growth and development. Historically, funds specifically earmarked for these efforts have been inadequate for a variety of reasons. As an example, the State Gasoline Tax is levied for the express purpose of supporting our highway and road systems, but it has been systematically eroding due to the fact that it is a flat rate per gallon rather than a percentage of price. Citizens in California also pay federal gasoline taxes, but we are a "net donor state" in that we receive less in transportation funding than we pay in as gasoline taxes. Various Statewide and regional revenue measures to provide transportation funding have been put in place, but some of these have expired while others have been suspended due to the State's fiscal problems.

Nevertheless, the traffic and transportation funding situation currently is more hopeful than it has been in some time. A permanent allocation from the State Proposition 42 appears to be at hand, the Federal government's new transportation funding program, called the Safe, Accountable, Flexible, Efficient Transportation Equity Act:A Legacy for Users (SAFETEA-LU) will provide increased funding to California through 2009 for highways, transit, and transportation safety, and the City has its own funding mechanism in place for major projects to support projected future land use.

Each of these potential funding sources is discussed below. During FY 2006/2007, City staff will be taking a comprehensive look at our overall transportation requirements in relationship to the various resources available. Recommendations from this review and strategic planning process will be incorporated into the projects budget that will be prepared next year.

State Traffic Congestion Relief Program and Proposition 42

The State Traffic Congestion Relief Program (TCRP) was passed as AB 2928 as part of the State's FY 2000/2001 Budget. Under this legislation, approximately $1 billion from the State portion of Sales Tax on gasoline sales was slated to go directly to cities and counties for preservation, maintenance and rehabilitation of local street and road systems for the period FY 2000/2001 through FY 2005/2006. These new funds were allocated on a per capita formula. AB 2928 funds imposed a maintenance of effort requirement that obligated the City to maintain a level of expenditures for street, road, and highway purposes equivalent to the average expenditures for FY 1996/1997, FY 1997/1998 and FY 1998/1999. In addition, a "use it or lose it" provision required that the City expend these funds by June 30th of the fiscal year following the one in which they were received. The legislation also required that the monies be held and accounted for in the City's Gas Tax Fund. A total of $1.6 million was received during FY 1999/2000 through FY 2002/2003 and spent for a variety of traffic signals and other traffic improvements. Due to the ongoing State budget crisis, Traffic Congestion Relief Fund payments to cities were suspended beginning in FY 2003/2004 and again in FY 2004/2005. A TCRP allocation for FY 2005/2006 in the amount of $556,000 was received by the City and used for pavement maintenance.

The total amount of deferred TCRP payments owed to the City of Sunnyvale is as follows:

Fiscal Year	Amount
2003/2004	$424,777
2004/2005	$398,236
Total due	**$823,013**

Under current law, the suspended TCRP amounts listed above are to be repaid, plus interest, by FY 2007/2008 and FY 2008/2009. The Governor's Budget currently proposes that some of these suspended payments be made in FY 2006/2007. If this proposal stays in the State Budget, Sunnyvale's would be repaid approximately $560,000 in FY 2006/2007 with the remainder paid in FY 2007/2008.

In March 2002, a constitutional amendment that permanently shifts the Sales Tax on gasoline from the State General Fund to the Transportation Investment Fund created by AB 2928 was approved by the voters as Proposition 42. The effect of this action was to indefinitely extend the allocation of Traffic Congestion Relief Program funds to cities, counties, and transit agencies beginning in FY 2008/2009. The Governor's State Budget for FY 2006/2007 proposes full funding of Proposition 42, but consistent with current law for the budget year, none of the revenues will be allocated for local streets and road purposes.

Funds for local streets and roads would begin flowing to cities and counties in FY 2007/2008 unless the State defers them again as is allowed by current law. The League of California Cities and a number of other interested groups are seeking legislative or initiative action to build a firewall around Proposition 42 funds that would prevent them from being hijacked again in the future, and early indications are that this effort will be successful. Staff has included Proposition 42 funds in the recommended FY 2006/2007 Budget beginning with approximately $700,000 in FY 2007/2008 and continuing throughout the Long Term Financial Plan. These are conservative estimates to take into account the current right of the State to defer the funds at any time. In any case, Proposition 42 funds received by the City will be utilized for various pavement maintenance and operations functions in the Public Works Department.

Federal Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU)

In October 2003, the Transportation Equity Act for the 21st Century (TEA-21) expired. This act provided federal transportation funding from 1998 through 2003 for highway and transit projects. In 2003 Congress extended TEA-21 for an additional two years, and in 2005 enacted the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU). The new legislation will provide a 40% increase in federal funding each year for transportation to California. Of particular interest is the fact that the new legislation ensures each state a minimum rate of return on its share of fuel tax contributions to the federal government. The rate will begin at 90.5% and increase to 92% in 2008. This represents an increase in return for donor states like California.

SAFETEA-LU funding is used primarily for statewide and regional high priority transportation and traffic projects. During the coming year staff will be reviewing the legislation and working with regional agencies to identify any opportunities for Sunnyvale to take advantage of these funds. The City has already realized allocation of $ 2.8 million in SAFETEA-LU funds for roadway rehabilitation which were appropriated to specific project in FY 2005/2006.

Traffic Mitigation Funds and Traffic Impact Fees

The City Council has adopted a Transportation Strategic Program as part of the Revenue Sources for Major Transportation Capital Improvement Projects Study Issue. The Transportation Strategic Program establishes a comprehensive funding program of revenue sources for major transportation necessary to support the City's land use plans.

Prior to the adoption of the Transportation Strategic Program, an interim funding mechanism was implemented for transportation mitigation of major land development. Known as Cumulative Traffic Mitigation funds, this mechanism mitigated project-specific cumulative impacts of major approved land developments as they related to the Land Use and Transportation Element of the General Plan. Implementing this interim funding measure offsets the potential revenue loss that would have resulted if the City waited until the Transportation Strategic Program was completed before implementing a fee or assessment. Cumulative mitigation funds are applied to capital projects that improve traffic capacity or alternative transportation facilities. Funds are allocated to projects of local or regional significance, depending upon the nature of traffic impacts identified in association with the land development.

The recommended FY 2006/2007 Budget includes approximately $2 million in projects to be funded by Traffic Mitigation Funds between FY 2006/2007 and FY 2015/2016. The Future Traffic Signal Construction/Modification project is proposed to fund one new traffic signal installation or major modification every other year, starting in FY 2006/2007. Additionally, a transfer from the Traffic Mitigation Fund to the Capital Projects Fund, Gas Tax Sub-fund in the amount of $90,400 is included in the recommended FY 2006/2007 for the Transportation Grant Matching Funds project.

The City Council adopted the Transportation Strategic Program in November 2003 and instituted a new Traffic Impact Fee to be applied to traffic-generating development citywide. This Traffic Impact Fee replaced the interim Cumulative Traffic Mitigation Fee. The City began collecting Traffic Impact Fees on new developments in January 2004. Traffic Impact Fees are to be applied to a specific list of roadway capacity improvement projects that were identified using a citywide transportation model.

It is currently projected that approximately $6.6 million in Traffic Impact Fees will be collected in the first ten years of the Long Term Financial Plan and an additional $6.7 million in the second ten years. One specific project is programmed for update of the City's computerized transportation model every five years starting in FY 2005/2006. The second project, Transportation Strategic Program, represents all projects that were identified in this program as approved by the Council in November 2003. This project is intended to implement projects identified in the Land Use and Transportation Element of the General Plan.

These funds are accounted for in the Traffic Mitigation Fees and Traffic Impact Fees Sub-funds of the Capital Projects Fund. More detail on the Traffic Mitigation and Traffic Impact Funds can be found in this Transmittal Letter in the *Detailed Fund Reviews* section.

Discretionary Transportation Improvement Funding

Each year the City pursues transportation improvement funding from a number of discretionary grant sources and programs, including the Santa Clara Valley Transportation Authority, the Metropolitan Transportation Commission, the Bay Area Air Quality Management District, and Caltrans. City policy calls for pursuit of outside funding to supplement City General or Gas Tax Fund expenditures for improvements. The City also has a list of unfunded projects which can be advanced in the schedule if discretionary funds are secured. In the past four fiscal years, the City has secured an average of $1.4 million per year from discretionary outside funding sources. To support discretionary grant writing efforts, the recommended FY 2006/2007 Budget contains a project in the Capital Projects/Gas Tax Sub-fund entitled Transportation Grant Matching Funds. This project provides local matching funds which are typically required by grantor agencies. The Transportation Grant Matching Funds project assumes average annual revenues of $825,000 from outside resources, with a 20% match requirement.

MAJOR PROJECTS IN RECOMMENDED FY 2006/2007 BUDGET

Plaza del Sol Phase II

The Plaza del Sol – Phase II project in the Park Dedication Fund was previously scheduled to begin design in FY 2011/2012 and construction in FY 2012/2013. However, due to the increase in Park Dedication Fee revenues projected in the next few years, it is recommended that this project be moved up earlier so that design will begin in FY 2006/2007 and construction in FY 2007/2008. The project will add additional features include landscaping, walkways, water elements, and roofing one of the two garage ramps. In response to Council direction given in December 2005, it also includes funding for a memorial dedicated to Sunnyvale residents and employees who have given their lives in service of the City and country. Funds in the amount of $203,980 are programmed in FY 2006/2007 and $2,025,000 for FY 2007/2008. Construction of Phase II of the Plaza del Sol will result in additional annual operating costs of $73,542 in FY 2008/2009.

Public Facility-HUD Section 108 Loans

A new project, Public Facility-HUD Section 108 Loans, is proposed for FY 2006/2007 in the Community Development Block Grant Fund (CDBG) for approximately $492,000. This project supports the preparation of an application that will be submitted to the U.S. Department of Housing and Urban Development (HUD) requesting a Section 108 loan to facilitate the expansion of the Columbia Neighborhood Center (CNC) and undertake other future neighborhood and economic development opportunities. Section 108 Loans provides federal loan guarantees to CDBG entitlement jurisdictions for pursuing large capital improvements or other projects. Jurisdictions must pledge their future CDBG allocations for repayment of the loan. The maximum loan amount can be up to five times the entitlement jurisdiction's most recent approved annual allocation. The maximum loan term is 20 years. The majority of the Section 108 loans will be in support of the CNC expansion.

ONGOING PROJECTS

The City's FY 2005/2006 Capital Improvement Program has three major projects that are currently being undertaken that will continue into FY 2006/2007. The status of each is discussed below to provide Council with an update on progress. Additionally, an update on the City's Infrastructure Renovation and Replacement Project is included.

Mathilda Avenue Railroad Overpass Replacement and Reconfiguration

The State of California Department of Transportation (Caltrans) inspects bridges throughout the state every other year for structural adequacy and functional operation. As per the Caltrans inspection report in 2000, the current Mathilda Avenue Railroad Overpass bridge design does not meet bridge pier clearance standards, deceleration lane design standards, shoulder width standards, and bridge railing standards.

City staff has successfully secured federal funds with 20% local match for removing the deficiencies and improving traffic circulation on the bridge. The proposed bridge improvements include reconfiguring the off ramp to Evelyn Avenue to allow full access to Evelyn from southbound Mathilda Avenue. As an added benefit, this improvement can service the anticipated increase in traffic from southbound Mathilda Avenue to downtown Sunnyvale.

A conceptual layout of the improvement proposal with a preliminary cost estimate of $17.5 million for the project has been submitted to Caltrans for funding purposes. The requirement of 20% local match translates to a maximum federal share of $14 million with the City's share of $3.5 million. However, Caltrans has indicated to City staff that a limit of $10 million of Federal Highway Bridge Rehabilitation and Replacement funding is placed on this project at this time. This would require the City to commit to a match of $7.5 million, while only $3.5 million is currently budgeted. This would leave a funding shortfall of $4 million. Caltrans has also indicated to City staff that increased funding requests are considered on a case by case basis upon completion of project design. City staff is continuing to work with Caltrans to increase funding. If this additional outside funding is not forthcoming, staff would not recommend that the project go forward in its current form.

Staff is in the process of completing the environmental review. An Environmental Impact Report has been prepared and circulated for public comments. The project design is anticipated to be completed in late 2006.

Borregas Avenue Bicycle Corridor

This project involves the design and construction of new bicycle and pedestrian bridges on Borregas Avenue over US 101 and State Route 237. The construction of overcrossings will eliminate approximately two miles of detours that currently exist for bicyclists and pedestrians who wish to cross over the freeways. The total project cost is $6.5 million, funded by various grants from the Valley Transportation Authority (VTA) in the amount of $4.8 million, a Transportation Development Act grant of $400,000 and Traffic Mitigation Funds of $1.3 million.

The project design and environmental reviews are complete. Staff anticipates recommending Council award of contract for this project in late 2006, after California Transportation Commission approves a funding allocation.

It is possible that the project would require additional funding because material costs for concrete and steel have risen sharply due to increasing demand. Additional funding may be available from the VTA on an 80%/20% matching basis. As design work and negotiations with the VTA continue, this project estimate will be modified to reflect the actual funding level and funding sources.

Mathilda/237 Area Transportation Improvements/Mary Avenue Extension

The Mary Avenue Extension is a project to improve access to the Moffett Industrial Park north of State Route 237. The project extends Mary Avenue from its current terminous at Almanor Avenue over US 101 and State Route 237 and connects to the roadway network in and around the Lockheed Plant 1 area. This project has been in the planning stages since the late 1980s and was included in the General Plan when the Land Use and Transportation Element was revised in 1997. The project is a major element of the City's long-range Transportation Strategic Program.

In 2004 the City and the VTA completed an operations analysis of the Mathilda/237 area, including an updated examination of the Mary Avenue Extension. This study identified a Mathilda/237/101 freeway interchange reconfiguration project and the Mary Avenue Extension as a viable medium to long-range improvement to serve the City's north-south travel corridors and to support projected growth in the Moffett Industrial Park. As a result, these projects were included as priorities for outside funding in the Valley Transportation Plan 2030 regional plan for Santa Clara County. To continue transportation and land use planning and to facilitate future outside federal or state funding for these projects, the FY 2005/2006 Budget included a project to conduct conceptual engineering, environmental work, and Caltrans-required studies for these improvements. The intended outcome is the establishment of a plan line for the Mary Avenue Extension, program-level environmental clearance, and initial Caltrans approval of these projects. The City has executed an agreement with the Valley Transportation Authority and work is underway.

Infrastructure Renovation and Replacement

Sunnyvale has traditionally provided funding in its operating budgets for optimizing maintenance of City infrastructure. Staff believes this to be the most cost-effective, long-term way to approach asset management.

Nonetheless, even with this proactive maintenance approach, eventually every infrastructure element reaches a point where maintenance is no longer a cost-effective strategy, and significant renovation and replacement is required. Funding of the renovation and replacement of the City’s estimated $1 billion in infrastructure assets is an enormous challenge, but it is critical to the long-term quality of life and financial condition of the City. The City has taken action on several fronts to deal with this challenge.

The City began development of a Long Range Infrastructure Plan (LRIP) several years ago. Phase I of the LRIP established the Infrastructure Renovation and Replacement Fund and incorporated full funding for General/Gas Tax and Community Recreation Fund assets. Over the past two years, the City has undertaken a new review and update of the scope, cost and original assumptions included in Phase I. Additionally, a preliminary version of Phase II of the LRIP has also been completed; Phase II addresses the fixed assets within the utility funds. These utility-related fixed assets have been identified and inventoried and the FY 2005/2006 Budget included preliminary estimates for replacement costs and schedules. Future capital budgets will further refine the costs and schedules for the various infrastructure projects.

In particular, the Water and Wastewater Funds have a large number of varied assets, including water mains, water valves, reservoirs, sewer collection systems, storm drains and the Water Pollution Control Plant. In order to provide more realistic estimates for future Capital projects, staff has been collecting data on how these fixed assets perform in varied conditions. The Water Pollution Control Plant has also undertaken an engineering study to inventory, assess remaining useful life/failure potential, and identify the replacement cost for all Plant infrastructure. The investigatory work regarding existing Plant assets has been completed and a draft final report has been prepared. The analysis portion of the report needs to be expanded to include an evaluation of the future capacity needs and applicability of existing Plant processes. This would included a determination of what equipment should be replaced “in-kind” as opposed to replacing with equipment capable of new processes or optimizing future performance and capacity of the Plant.

The update of Phase I and the refinement of Phase II of the LRIP are ongoing. At this time, the LRIP utilizes a broad based approach that looks at categories of assets, their replacement costs and the annualized costs to upgrade or replace those assets over the next 40 years. The next activity is to take the information compiled to date and convert it into a database that will allow more sophisticated search and financial modeling functions. It is expected that the data base conversion will be completed by the end of the 2006 calendar year, and revised project descriptions and costs will be included in the Projects Budget for FY 2007/2008.

The Public Works Department is also currently undergoing an Optimal Staffing Study which will include some Best Management Practices (BMP) recommendations. It is anticipated these BMP recommendations will include some relating to the maintenance and rehabilitation of infrastructure. Those BMP’s that are ultimately adopted by the City may require modification of, or incorporation into, the LRIP.

DEFERRED PROJECTS

Morse Avenue Neighborhood Park Development

The Adopted FY 2002/2003 Budget contained a capital project funded by the General Fund for development of a Morse Avenue Neighborhood Park. This project provided for the closing of the Fair Oaks Industrial Park and the construction of a neighborhood park on the site. The Fair Oaks Industrial Park was purchased by the City in 1990 in anticipation of future park needs for the area between State Highway 237 and U.S.

Route 101 and Tasman. Rental income to the General Fund from the Industrial Park has averaged about $900,000 annually since its purchase, with expenditures to operate equaling about $275,000. In the Adopted FY 2002/2003 Budget the park project was scheduled to begin design in FY 2007/2008 and be completed in FY 2008/2009. Operating costs for the park were anticipated at that time to be about $80,000 annually.

Subsequent to the Adopted FY 2002/2003 Budget, Council deferred construction of the park for two years so that the annual net income of $625,000 could be used on behalf of the Plaza del Sol Phase I project.

As part of the recommended FY 2003/2004 Budget, the then City Manager proposed a series of expenditure reductions and revenue enhancements to cover an estimated $15 million structural gap in the General Fund. Part of this reduction package was to delete the Morse Neighborhood Park project from the twenty-year Financial Plan and retain the Industrial Park as an income producing asset throughout the twenty years. This recommendation was made in order to save the initial capital costs of the park construction, to avoid new ongoing operating park maintenance costs, and to retain the substantial net rental income of the Industrial Park to the General Fund. This recommendation was accepted by the City Council as part of the FY 2003/2004 Budget adoption.

Currently, the Morse Avenue Neighborhood Park Development project remains unfunded. From 1993 to 2002 no residential development occurred in the Industrial To Residential (ITR) 7 and 8 Zones where the Industrial Park is situated. However, the economy shifted in 2002 in favor of residential construction and residential conversion of the area has progressed. Currently, about 40% of the possible residential units in the area have been built or approved for construction. In light of the greater than anticipated redevelopment of the ITR area into housing, staff is recommending that the appropriate timing for construction of the Morse Avenue Neighborhood Park be evaluated during next year's capital budget process.

As indicated earlier in this Transmittal Letter, an initiative that will be undertaken during FY 2006/2007 is a complete reevaluation of the City's open space assets in relationship to our overall neighborhood parks strategy. The Morse Avenue Neighborhood Park issue will be reviewed in this context.

HUMAN SERVICES OUTSIDE GROUP FUNDING

Although the primary support of individuals and families who cannot fully support themselves comes directly from the federal and state governments, Sunnyvale has for decades provided supplemental support to its needy residents through funding of local human services agencies. The principal source of this funding has been Community Development Block Grant (CDBG); by statute, up to 15% of the annual CDBG entitlement plus program income from the prior year may be utilized for such purposes. The City has also supplemented federal funding with some General Fund support.

FY 2006/2007 is the second year of a two-year funding cycle to provide funding to human service agencies. (The revised Human Services Policy which City Council adopted on April 11, 2006, will apply to the next full funding cycle, beginning in FY 2007/2008.) During the second year of funding, the City does not solicit applications; rather, those agencies which have met or exceeded performance standards are recommended for funding for a second year, with a funding reduction in proportion to any reduction in available federal CDBG or General Fund support.

Unfortunately, there is a 22% reduction in available CDBG funding, from $350,000 in FY 2005/2006, to $271,600 in FY 2006/2007. This is due to reduced CDBG appropriations at the federal level and to a return to normal program income, compared to unusually high program income last year. General Fund support is recommended to remain at the FY 2005/2006 funding level of $97,458.

The proposed funding is based upon recommendations of the Housing and Human Services Commission (HHSC). On May 9, 2006, City Council is considering the allocation of the $271,600 using CDBG funds. CDBG funding for all agencies was reduced by 22%, except for two underperforming agencies which were reduced an additional $1,000. The recovered $2,000 was redistributed to the performing agencies in proportion to their base allocation. The total reduction to all agencies, excluding the two under-performing agencies, is 16.77% when considering both CDBG and General Funds. This reduction is then applied to all performing agencies so that the General Fund total remains at $97,458. In effect, General Fund monies are used to subsidize the CDBG funding for all performing agencies so that each agency receives a lower net reduction of 16.77% instead of the overall CDBG reduction of 22%.

It should be noted that based on Council direction provided at the April 11, 2006 meeting, starting in FY 2007/2008, Outside Group Funding support for Human Services programs should be funded only using CDBG funds. Agencies which have been traditionally funded through the human services process but which do not meet the definition of "human services" will be directed to appropriate City departments for consideration of Special Agreements for continuation of the service in accordance with Council Policy 7.2.4, Relationships with Outside Groups.

DETAILED FUND REVIEWS

While it is useful to understand the City's overall budget, it is important to underscore that the City's budget is comprised of multiple funds, with the real short-term and long-term position of the City contained in the respective position of each of these funds. This Transmittal Letter will discuss each fund in detail, but places emphasis on the General Fund.

The following review will provide strategic long-term, as well as important short-term, financial highlights for each individual fund.

GENERAL FUNDS

The General Fund is used by the City to account for all financial resources except those required by law or practice to be accounted for in another fund. Due to the fact that operation of the Gas Tax Fund is inextricably intertwined with the General Fund, it is included in the General Fund discussion.

General Fund

The General Fund supports many of the most visible and essential City services, such as police, fire, road maintenance, libraries, and parks and open space maintenance. General government support functions are also included in this fund, and their costs are apportioned through the use of in-lieu fees to other City funds. Because the General Fund receives the preponderance of its revenue from taxes, it has been the most affected by voter-approved initiatives and State legislative actions. As a result of such action over the past decade, revenues to the General Fund are significantly less than they would have otherwise been. Additionally, the state of the regional economy has a direct effect on the General Fund.

The General Fund has a very close relationship with several other funds. Those funds are the Community Recreation Fund, the Youth and Neighborhood Services Fund, the Gas Tax Fund, the Internal Service Funds, the Capital Projects Fund, the Infrastructure Renovation and Replacement Fund, and the Redevelopment Agency Fund. In each case, the condition of these funds has a direct bearing on the General Fund due either to contractual relationships or because the General Fund is a primary or significant source of financial support. The relationship between these various funds, where appropriate, will be discussed as a part of the General Fund, as well as in the review of each of these individual funds.

General Fund Revenues

Revenue Estimation Methodology

All revenue assumptions and projections are reviewed and revised each fiscal year. Further, considerable analysis is undertaken to identify the key elements that impact our major revenue sources so that the projection methodology is reliable over the long-term. Historical data underscores the fact that a significant swing in revenues can occur due to economic cycles. From a low in 1990 to the high in 2000, the economy has produced very different revenue yields to the City in a number of major categories. Projecting revenues based on the high point of the economic cycle could overstate the City's financial position significantly for future years and could result in spending patterns that cannot be sustained. Conversely, projecting revenues from the lowest point of the economic cycle could understate the long-term financial position of the City and cause unnecessary service reductions.

Each revenue source has its unique characteristics that have been used to make projections. In general, estimates of actual revenue for each major source are used to calculate FY 2006/2007 figures. For the balance of the financial plan, however, projections are based on a defined business cycle for each revenue modified for present circumstances. Because these projections are based on historic trends and assumed business cycles, they will need to be closely monitored and corrected to reflect any change in patterns or circumstances.

The on-going national recession has resulted in steep declines in the City's major revenues. It now appears that most of our key revenues have finally bottomed out and begun to grow. In some cases, our revenues have stabilized at a new, lower base level to reflect the new economic reality of our region. Additionally, several State initiatives have redefined or modified our revenue sources or the manner in which they are allocated. Most notable among these initiatives are the "Triple Flip," the Vehicle License Fee/Property Tax Swap, and the "Educational Revenue Augmentation Fund (ERAF) III".

<u>The Triple Flip</u>

In FY 2004/2005 the State issued "Economic Recovery Bonds" as part of the solution to its record budget deficit. These bonds are secured by a mechanism called the "Triple Flip" which swaps local Sales Tax for Property Tax while the bonds are outstanding. In short, the State moves money from cities and counties to the State by raising the State Sales Tax rate by ¼ cent and reducing the local Sales Tax rate by an equal amount. So that cities and counties aren't hurt, an equal amount of Property Tax is taken from the schools (the Educational Revenue Augmentation Fund or ERAF) and given to the cities and counties. The State then makes up this loss by giving the schools an equal amount of money from the State's general fund.

When all of the flips are completed, everyone has the same amount of money as before, but a substantial amount of the State's money will now be in a special fund to pay debt service on the bonds instead of in the State's general fund.

The actual Triple Flip began in July 2004. The exchange mechanism will be in place as long as the Bonds are outstanding, and it unwinds automatically when the Bonds are paid off. Although the final maturity of the Bonds is 2023, it is expected that they will actually be fully repaid in nine to ten years because of certain provisions in the bond covenants and in the Proposition that authorized them.

The recommended FY 2006/2007 Budget for the General Fund assumes that the Triple Flip mechanism will be in place over a ten-year period beginning July 1, 2004.

Staff has reduced our Sales Tax projections each year by one-fourth and reflected it as a separate line on the General Fund Long Term Financial Plan called "*Triple Flip - Sales Tax Reduction.*" This same amount is then added to the Property Tax projections in a separate line entitled "*Triple Flip - Property Tax Increase.*" In the Triple Flip, the Sales Tax/Property Tax swap is dollar for dollar based on the actual Sales Tax revenue collected and it does not actually increase the City's Property Tax base. There is no net fiscal impact to the City of the Triple Flip. The major effect of this mechanism on the City lies in the fact that Property Tax is essentially remitted to us twice a year while Sales Tax is remitted monthly; this causes a reduction in our interest earnings and a potential cash flow problem. We have taken this effect into consideration in our interest earnings projections for the General Fund.

Vehicle License Fee/ Property Tax Swap

Also included in the State Budget deal with local governments last year was a permanent redistribution of two of the City's revenue sources. Under this agreement, the Vehicle License Fee (VLF) rate was permanently reduced from 2% to .65%. For FY 2004/2005, the VLF that the City would have gotten at the 2% rate was calculated and this amount was added to our Property Tax base through transfers from the Educational Revenue Augmentation Fund (ERAF). In FY 2005/2006, the City has been receiving our portion of VLF revenues at the now-permanent low rate. Meanwhile, our Property Tax base reflects the new, permanent base. This Property Tax base will grow in the future according to current economic conditions.

With the swap now in place, Vehicle License Fee is no longer one of the City's major revenue sources. It should be noted that the VLF/Property Tax shift results in a financial loss to the City in two areas. First, since Property Tax is paid twice a year while VLF is paid monthly, there is a cash flow and interest earnings loss. Second, and most importantly, the Property Tax rate of growth has historically been lower than the growth rate of VLF revenues. However, it should also be noted that the VLF is a relatively precarious revenue source that would probably be eliminated or reduced by popular demand in the near future. This new approach takes this risk away from cities and guarantees our revenues through Property Tax, which has now surpassed Sales Tax as our largest tax source.

Educational Revenue Augmentation Fund (ERAF) III

The final part of last year's State Budget agreement involved a two-year "contribution" of the City's Property Tax revenues to the State Educational Revenue Augmentation Fund (ERAF). Since this is the third time since 1990 that the State has dipped into our Property Taxes in this manner, the loss was called "ERAF III." The loss from "ERAF I and II" is estimated to be $6.7 million. The amount of revenue that Sunnyvale has lost for "ERAF III" for FY 2004/2005 and FY 2005/2006 is $2,051,370 each year. The FY 2006/2007 Long Term Financial Plan for the General Fund assumes that there will be no further ERAF Property Tax shifts because of the recent constitutional protection of city tax revenues.

General Fund Major Revenue Sources

Five key sources generate about 76% of the City's General Fund revenues. They are: Sales Tax, Property Tax, Transient Occupancy Tax, Utility Users Tax/Franchise Fees, and Construction-related taxes and fees. The FY 2005/2006 Budget projected that revenues from these sources would moderately increase over the next few years as the economy began a measured rebound. Receipts in Sales Tax, Property Tax, Transient Occupancy Tax, and Construction-related revenues have all increased during FY 2005/2006. Our projections reflect increases over the next few years in every major category. However, some uncertainty surrounding the economy exists due to rising interest rates and the slowdown of the residential housing market.

Table IV, on the next page, reflects projected major sources of General Fund revenues for FY 2006/2007 and compares those sources with the FY 2005/2006 revised projections. Actual revenues for FY 2004/2005 are also included. Overall, our FY 2006/2007 revenues are forecast to be about 4.79% higher than estimated FY 2005/2006 revenues and 8.27% higher than what was projected for FY 2006/2007 in last year's financial plan.

Table IV Recommended Revenues – General Fund					
Revenue Character	**2004/2005 Actual**	**2005/2006 Revised Projection**	**% Growth 2005/2006 over 2004/2005**	**2006/2007 Proposed Projection**	**% Growth 2006/2007 over 2005/2006**
Property Tax*	23,951,067	25,449,764	6.26%	26,234,220	3.08%
ERAF III	(2,051,370)	(2,051,370)	0.00%	0	-100.00%
Property Tax in Lieu of VLF	7,610,070	7,619,808	0.13%	7,916,076	3.89%
Sales Tax*	24,917,237	27,436,523	10.11%	28,446,552	3.68%
Utility Users Tax	5,832,872	5,954,216	2.08%	6,123,042	2.84%
Franchises	5,394,792	5,479,681	1.57%	5,688,840	3.82%
Transient Occupancy Tax	5,073,824	5,461,025	7.63%	6,109,305	11.87%
Permits and Licenses	4,995,591	5,277,731	5.65%	5,725,618	8.49%
Inter-Fund Revenues	5,617,412	5,337,821	-4.98%	5,127,249	-3.94%
State Shared	4,352,479	1,216,406	-72.05%	1,251,043	2.85%
Service Fees	2,725,137	3,715,625	36.35%	3,405,341	-8.35%
Interest	2,435,403	3,327,852	36.64%	3,073,609	-7.64%
Other Taxes	2,275,899	2,086,182	-8.34%	2,156,557	3.37%
Business License Tax	214,895	260,000	20.99%	473,000	81.92%
Miscellaneous	2,040,739	801,529	-60.72%	543,560	-32.20%
Rents and Concessions	1,319,970	1,731,821	31.20%	2,214,753	27.89%
Prop. 172 Sales Tax	1,152,670	1,217,253	5.60%	1,255,718	3.16%
Fines and Forfeitures	838,637	814,950	-2.82%	875,045	7.37%
Federal and Intergovernmental Revenues	293,828	180,003	-38.74%	126,080	-29.96%
Real Property Sale	0	550,000	-	0	-100.00%
TOTAL	**98,991,152**	**101,866,820**	**2.90%**	**106,745,508**	**4.79%**

** Property Tax and Sales Tax revenues do not include the impact of the Triple Flip.*

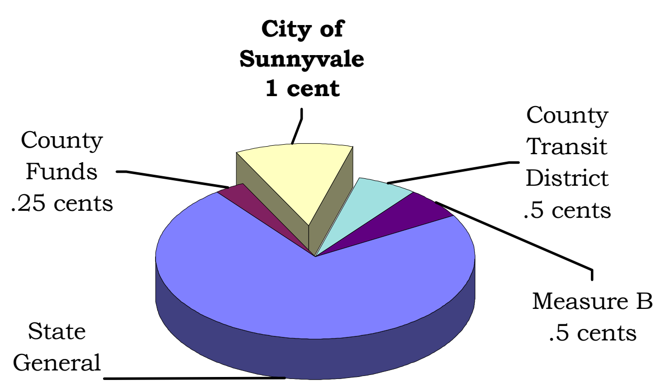
In the following section are detailed discussions of the City's five major revenue sources: Sales and Use Tax, Property Tax, Utility Users Tax/Franchise Fees, Transient Occupancy Tax, and construction-related revenues. This information will include explanations of the revenue forecasts for FY 2006/2007 and beyond. Following that section will be discussions of several other revenue sources of particular note.

Sales and Use Tax

Sales and Use Tax represents the second largest source of revenue to the General Fund, making up 26% of budgeted revenues in FY 2005/2006. In FY 2000/2001 Sales Tax represented the largest revenue source and constituted 32% of total revenue. Since FY 2000/2001 Sales Tax revenue has fallen at a dramatic rate of 35% or nearly $13 million. However, in FY 2003/2004 Sales Tax revenues increased slightly from the prior year, marking the first time the City had seen a year-to- year increase since the peak of the "dot com" era in FY 2000/2001. This trend of moderate recovery continued in FY 2004/2005, with an increase of 6.2% over the prior year. Currently, we are projecting that the recovery in Sales Tax revenues will continue strongly in FY 2005/2006.

The graph below shows how Sales Tax dollars are distributed within Santa Clara County. The State receives the largest share of the eight and one quarter cents per dollar of sales, while cities receive only one cent of the rate.

Sales Tax Distribution
8.25 Cents per Dollar - Santa Clara County



Source: State Board of Equalization

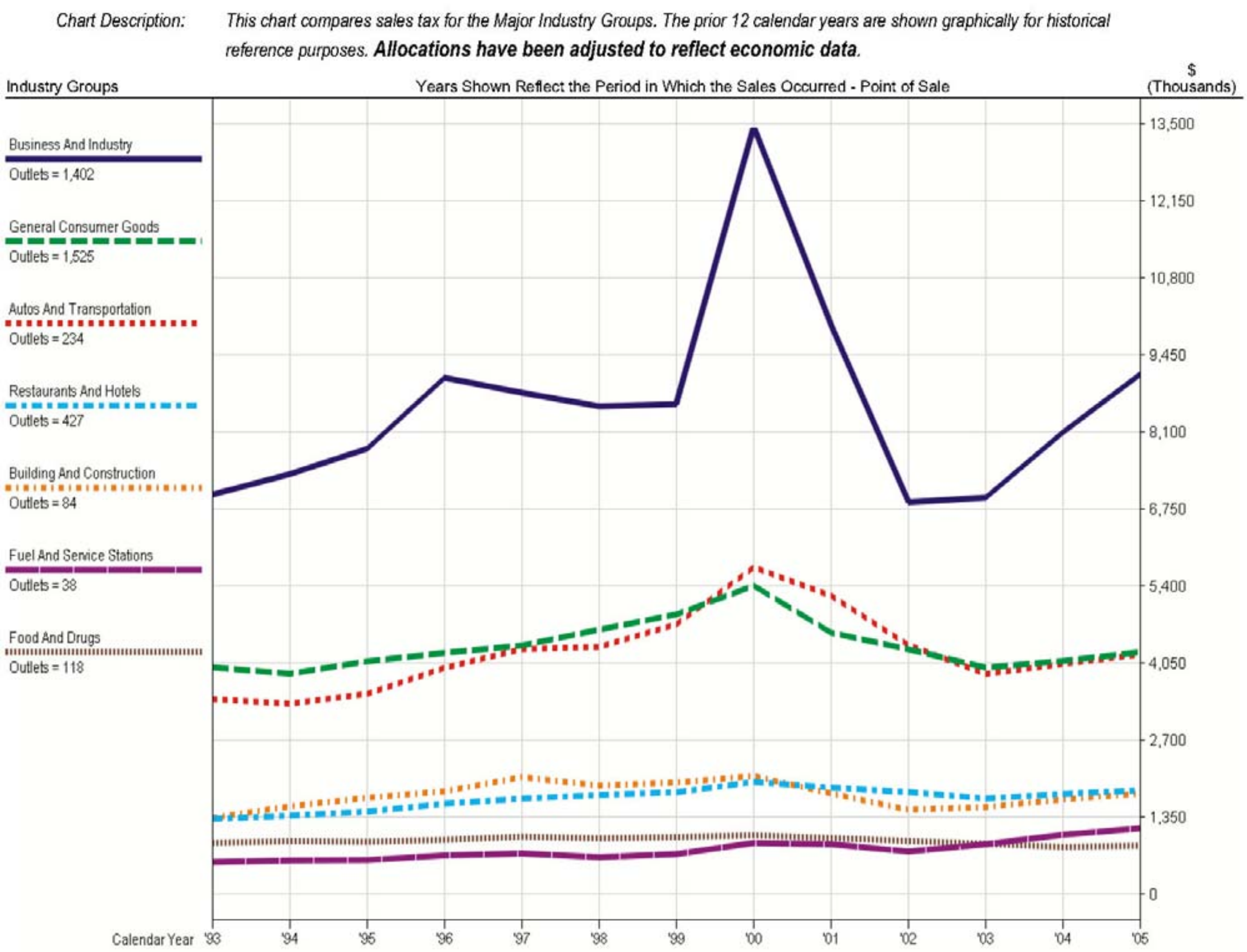
Sales and Use Tax is composed of two different types - general retail sales and business-to-business sales. In Sunnyvale, as well as some other Silicon Valley cities, an unusually high proportion of overall Sales Tax has traditionally been business-to-business in nature; this sector currently constitutes about 39% of our aggregate as opposed to the statewide average of 17%. This makes our Sales Tax much more complicated and difficult to predict because it is often one-time in nature.

Our revised Sales Tax estimate for FY 2005/2006 is $27.4 million. This is up approximately 10%, or $2.5 million, compared to our actual receipts for FY 2004/2005. This 10% increase is the result of two factors. The first factor is accelerated spending, particularly in the business-to-business sector, which reflects a pent-up demand for technical products. Staff's projections for FY 2005/2006 in the adopted FY 2005/2006 Budget had the business-to-business sector recovering at a more measured pace. The second factor is the inclusion in the FY 2005/2006 Sales Tax revenues of several large Use Tax transactions that are one-time in nature. These transactions do not add to the ongoing Sales Tax base.

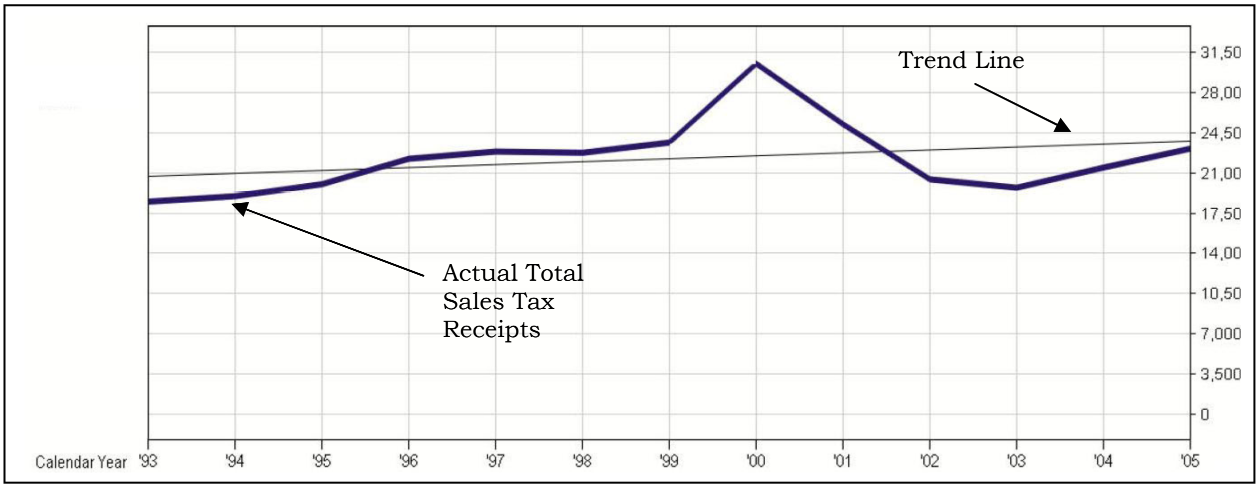
For developing ongoing projections of Sales Tax revenue, staff analyzed Sales Tax receipts to identify the City's ongoing Sales Tax base. The large one-time Use Tax payments were removed from the base, and several new Sales Tax generators were added. The ongoing Sales Tax base that we are using for projection purposes is $27.2 million.

After developing the ongoing Sales Tax base, we further divided Sales Tax receipts into four major categories that had similar economic characteristics: Business and Industry, General Consumer Goods, Autos and Transportation, and Other. As can be seen from the graph below, each category has a unique pattern:

City of Sunnyvale
Sales Tax Receipts by Major Sector
(Calendar Year 1993 – 2005)



City of Sunnyvale
Total Sales Tax Receipts with 13-Year Trend Line
(Calendar Year 1993 – 2005)



In forecasting our Sales Tax revenues for the next two years and the balance of the financial plan, staff developed individual projections for each sector, and then assimilated the numbers into a single weighted aggregate forecast of growth. Review of the historical data indicated that the Sales Tax had a seven-year economic cycle, which is reflected in our projections over the entire Long Term Financial Plan.

As mentioned above, staff also took into account the known increases and decreases in companies in the City. Several significant business-to-business Sales Tax producers have relocated to other cities. However, several major retail Sales Tax generators have recently been opened in Sunnyvale and we have taken the net effect of these businesses into our base for projection purposes. Additionally, Sunnyvale's reenergized automobile dealers have generated a higher level of sales that appears to be sustainable over the long term, which also adds to our ongoing Sales Tax base. Staff has factored these new additions and identifiable losses into our long-term forecast.

Projections for FY 2006/2007 are that the City's Sales Tax revenue will increase by approximately 3.7% above this current year, to $28.5 million. This is about $2.5 million higher than the $26 million projected for FY 2006/2007 last year. Our projection for FY 2006/2007 reflects continued strong growth in the automobile sector and moderate growth in the other areas. Growth in FY 2007/2008 through FY 2009/2010 is expected to slow to reflect the current seven-year economic cycle. Sales Tax growth estimates are in the 2.5% to 3% range in those years. The upswing begins in FY 2010/2011, with growth expected to rise to approximately 5% in FY 2013/2014. The remainder of the Long Term Financial Plan projects Sales Tax growth in accordance with the established economic cycle.

The "Triple Flip" mechanism, implemented by the State beginning July 1, 2004, has also changed the way that Sales Tax is received and accounted for by the City. As discussed earlier, in the Triple Flip, 25% of the local portion of Sales Tax is swapped with Property Tax dollar for dollar based on actual sales collected. The County will estimate the amount of in-lieu Property Tax to be remitted to us based on last year's receipts, and then reconcile their remittances in January of the following year.

In summary, Sales Tax revenues have experienced wild swings over the last several years. Sunnyvale experienced unprecedented growth of about 20% per year in Sales Tax receipts in FY 1999/2000 and FY 2000/2001 due to a "boom" in high technology business. Unfortunately, this level of revenue was not sustainable. The recent economic downturn was already impacting City revenues four years ago, as the stock market was undergoing dramatic declines and numerous companies across the nation were implementing cost saving measures that included reducing capital investment. Staff believes that our sustainable Sales Tax base has stabilized and we are now experiencing a solid recovery, particularly in our business-to-business sector. Several new retail sales producers have also opened in Sunnyvale. Finally, stronger automobile sales have contributed to the increased revenues and added to our ongoing base.

Property Tax

Property Tax now represents the largest source of General Fund revenue. Property Tax is up considerably as a percent of General Fund revenues compared to the prior year as a result of the VLF/Property Tax Swap. Property Tax now represents 33% of all General Fund revenues.

The City's Property Tax revenue consists of several categories. Secured Tax, which represents the vast majority of the overall Property Tax, is the tax on real property and the structures on that real property. Unsecured Tax represents the tax on assessments such as furniture, machinery, and equipment. Supplemental Tax is the result of reassessing the value of real property when there is a change of ownership or new construction is completed after the official lien date. Other sources of Property Tax revenue come from Unitary Tax, which is assessed by the State Board of Equalization on property such as railroad lines, and Tax Delinquencies.

Property Tax has also been the revenue most affected by voter initiatives and legislative actions. With approval of Proposition 13 more than 20 years ago, Property Tax revenues were reduced by two-thirds and thereafter limited to 2% annual increases or the CPI, whichever is less. In the early 1990s, the State legislature shifted a larger portion of the Property Tax to schools. This shift was made to the State's Educational Revenue Augmentation Fund ("ERAF") to backfill a portion of the State's obligation for school funding. This "ERAF shift" is now 3% of the Property Tax dollar, representing an annual loss to the City of Sunnyvale currently amounting to approximately $6.7 million. Cumulatively, the total ERAF shift from the beginning represents a loss of over $70 million to Sunnyvale through FY 2005/2006. Most recently, the State shifted an additional $4.1 million from Sunnyvale Property Tax to the ERAF as part of its FY 2004/2005 and FY 2005/2006 Budgets. ("ERAF III") Fortunately, this was not an ongoing shift and any further permanent shifts have been precluded by the passage of Proposition 1A in November 2004.

Overall FY 2005/2006 Property Tax revenues are expected to be up approximately 5.0% when compared to FY 2004/2005, including an estimated 6.8% Secured

Property Tax growth. Continued robust residential segment valuation growth has been the primary driver for this increase.

A similar model to that used for our Sales Tax forecasts is also used to project Property Tax revenues. For Secured Property Tax, staff isolated the assessed valuations for both residential and commercial/industrial, as each segment represents different stages of the economic cycle. Revenue from Secured Property Tax, which represents about 85% of total Property Tax revenues, is projected to increase by approximately 4.0% in FY 2006/2007. Valuation growth and turnover in the residential market is not expected to be as robust as it has been over the past several years because the housing market has slowed due to rising mortgage rates. However, revenues from Property Tax lag the economic cycle by at least one year because of the timing of the assessment and collection process. To reflect these factors, Secured Property Tax growth for residential properties has been projected at 6% for FY 2006/2007. Although the assessed valuation of commercial/industrial properties has experienced an actual decrease over the last several years, we are projecting no increase in value for FY 2006/2007 because it appears that the market has bottomed out.

In FY 2007/2008 we anticipate 5% growth in the residential segment and 4% growth in the commercial and industrial sectors. This increase in commercial and industrial reflects an improvement in the occupancy rate and selected new development. Average residential growth for the remainder of the first ten years of the Long Term Financial Plan is estimated at 5% annually. Commercial and industrial growth is projected to average 5% per year through FY 2010/2011 and range from 4% to 2% through FY 2015/2016. These projections reflect stabilization of valuations and modest year-over-year growth in revenue for the commercial and industrial sectors.

The Vehicle License Fee/Property Tax Swap that was part of the State budget in FY 2004/2005 has been reflected in our Property Tax projections on an ongoing basis. As discussed earlier, the Property Tax base has been increased in relationship to a reduction in Vehicle License Fee revenues. This increase is now permanent, and the new base now grows in the following years with the growth of Property Tax.

Two other important elements of Property Tax revenue are the Unsecured Property Tax and Supplemental Property Tax rolls. Unsecured Property Tax grew significantly during the height of the economic boom and has slowly reduced to about $2 million in FY 2005/2006. This decline in Unsecured Property Tax reflects the continued vacancy in our research and development and commercial buildings, the departure of several manufacturing facilities, and the continued hesitancy of businesses to expand operations and purchase or replace capital equipment. We expect Unsecured Property Tax to increase significantly in FY 2006/2007 due to certain properties being reclassified from Secured to Unsecured and then follow the economic cycle reflected in Secured Property Tax over the Long Term Financial Plan.

The Supplemental Property Tax roll reflects properties that are sold or transferred after the official lien date. Supplemental assessments pick up the higher value on the property immediately by using a floating lien date, and the added assessed value is placed on a separate Property Tax bill. Revenue from the supplemental roll is dependent strictly upon timing of sales and thus is difficult to forecast. The City has experienced a sharp rise in Supplemental Property Tax revenue in FY 2005/2006 due to the recent strong residential real estate market. Current indications are that the housing market is slowing significantly. Projections for the Supplemental Roll starting in FY 2006/2007 reflect a decrease due to the slowing housing market and thereafter utilize the economic cycle mentioned above.

Utility Users Tax and Franchise Fees

Utility Users Tax (UUT) and Franchise Fees combined represent the third largest source of General Fund revenue, generating about 10% of the total. Historically, these two revenue categories have been combined because one of the primary sources of revenue for both is sale of electricity and gas.

The City's UUT revenues are based upon receipts from intrastate telephone, gas, and electric usage. Approximately 59% of UUT revenue is derived from the sale of electricity, 26% is related to intrastate telephone usage, and 15% is derived from the sale of gas.

Total receipts from UUT for FY 2005/2006 are expected to be up by 2% compared to last year's receipts. This increase is due to higher sales by Pacific Gas & Electric (PG&E) for natural gas. The single largest component of UUT revenues is the electric rates charged by PG&E. Although UUT on PG&E electricity is down slightly this current year, growth in this area is expected for FY 2006/2007 when electric rate increases which went into effect in January 2006 are realized in UUT revenues. Based on information from PG&E regarding their general rate case, we expect electric revenue to be flat for FY 2007/2008. PG&E UUT remittances are expected to grow by 2% annually for the remainder of the first ten years and 3% annually for the last ten years of the Long Term Financial Plan. These projections are based upon information from PG&E and the California Department of Finance regarding trends in energy costs.

The City also receives approximately $1.6 million annually from UUT on intrastate telephone usage. Although the various providers have changed year over year, overall receipts have been fairly stable. The telephone UUT is expected to only grow by 1% annually throughout the Long Term Financial Plan. This is based on the cost reductions in calling plans due to the competitive telephone market.

The City receives a one-time franchise payment from PG&E each year which represents approximately 40% of all Franchise Fee revenue. The City's other main franchise agreements are with Comcast Cable and Specialty Garbage. Franchise revenues are expected to meet budgeted projections for FY 2005/2006. For FY 2006/2007 Franchise Fees are projected to increase by 3.8% over the current FY 2005/2006 projection to reflect the full impact of the recent PG&E electric rate hike. Future year projections include an increase of approximately 2.7% annually from FY 2008/2009 through FY 2015/2016 and approximately 4% annually in the second ten years of the Plan.

Transient Occupancy Tax

Transient Occupancy Tax (TOT) represents the fourth largest revenue source of the General Fund, constituting about 5% of the total.

Beginning in approximately 1995, improved economic conditions led to higher occupancy rates and room charges, as well as the addition of several new hotel and motel properties. Our TOT rate was also increased from 8% to 8.5% in 1995. As was seen during the recent economic downturn, this revenue is particularly susceptible to business cycles because both occupancy rates and room rates are closely linked to economic conditions. The bulk of our TOT revenue stems from weekday business travel. The Sunnyvale TOT rate, at 8.5%, is the lowest in Santa Clara County. Most cities are at 10%, with Santa Clara at 9.5%. However, beginning January 1, 2007, the Sunnyvale TOT will increase to 9.0%, which will have an impact of approximately 5.9% on TOT revenues.

Since bottoming out in FY 2003/2004, TOT revenues have been on the rise. FY 2005/2006 projections are for a nearly 8%, or $400,000, increase in TOT revenues compared to FY 2004/2005. This also represents an approximate $200,000 increase over original FY 2005/2006 projections. Much of this is attributable to continued improvements in the average occupancy rate, which is currently around 62% to date this fiscal year. This is a marked improvement over the past several years during which occupancies remained well below 60%.

Projections for FY 2006/2007 and FY 2007/2008 call for over 12% annual growth in TOT revenues, primarily due to the implementation of the 9.0% tax rate beginning January 2007. Other factors contributing to this growth include expectations for continued increases in occupancy and room rates. The occupancy rate is projected to grow to 70% and is then adjusted for the economic cycle in the long term financial plan. The room rate is projected to grow 4% for FY 2006/2007 from the current average rate of approximately $82.50. Average growth for the remainder of the first ten years of the Long Term Financial Plan is projected to be 5.1%. Factors positively impacting growth include the reopening of the new hotel property on the Four Points Sheraton site late in 2008 and the implementation of an additional .5% increase to the TOT rate beginning in January 2009. When fully implemented the raising of the TOT from 8.5% to 9.5% will represent an 11.76% increase in revenues. While these two factors are expected to have a significant impact on TOT revenue growth, this growth will be tempered by cyclical economic factors that are expected to drop occupancy rates and slow room rate growth in some years. 5% annual TOT revenue growth is projected in the final ten years of the Long Term Financial Plan.

Construction-Related Revenue

Construction-related revenues represent about 6% of General Fund revenues in the current year. This category includes Construction Tax as well as receipts from the issuance of building, electrical and other permits. Plan Check Fees are also reflected here. The economic downturn that caused the levels of construction-related revenue to trend downward significantly in FY 2001/2002 and FY 2002/2003 has given way to several years of construction-related revenue growth. FY 2005/2006 marks the third consecutive year of growth for construction-related revenue, with FY 2005/2006 projections exceeding last year's actuals by over 11%. This growth has been fueled by a large number of residential development projects.

Future years' projections are based on a rolling seven-year economic cycle. The forecast for FY 2006/2007 is for construction-related revenue to peak at nearly $7.26 million, including Construction Tax. FY 2007/2008 is expected to experience a modest decline in revenues, with projections still exceeding $7 million. Revenues are expected to fall significantly in FY 2008/2009 and FY 2009/2010 to reflect the downside of the seven-year cycle before rebounding in FY 2010/2011 and growing through FY 2013/2014. The business cycle will then be repeated over the remainder of the planning period.

Other Revenue Highlights

The recommended FY 2006/2007 Budget includes certain other revenue sources which need some explanation.

Interfund Revenues

Interfund Revenues include repayment to the General Fund of various loans made to other funds. Also included here is the repayment by the Redevelopment Agency of the General Fund advance. For the recommended FY 2006/2007 Budget a new revenue line has been included to reflect increased repayment by the RDA to the General Fund due to the redevelopment of the Town Center Mall. It should be noted that a corresponding expenditure is also included to reflect the Payment to the Mall developer of this increased tax increment generated by the project.

State Shared Revenues

Actual state shared revenue received was high for FY 2004/2005 because of the State's repayment of its FY 2003/2004 VLF loan in the amount of $2.2 million. This is one-time revenue that represents early collection by the City of monies owed by the State as a result of the City participating in the VLF Loan Receivable Financing program.

Miscellaneous Revenues

The decline in Miscellaneous Revenues from FY 2004/2005 to FY 2005/2006 is attributable to one-time revenues received during FY 2004/2005. Audits and other staff efforts brought in approximately $865,000 in general liability, bankruptcy, and audit recoveries. Additionally, approximately $300,000 in revenue was brought in from unclaimed property. The decline from FY 2005/2006 to FY 2006/2007 is primarily attributable to $76,000 in miscellaneous reimbursements projected for FY 2005/2006 that are not expected to be recurring, as well as the reclassification of approximately $60,000 in revenues to other revenue object codes.

Rents and Concessions

Projections from Rents and Concessions revenue are up approximately 28% for FY 2006/2007 due to the inclusion of certain rentals that formerly were included in the

Community Recreation Fund. Specifically, rentals at the Raynor Center and rentals for park buildings, picnic areas, and athletic fields are now being accounted for in the General Fund to more correctly align revenues with expenses. A full discussion of this change is included in this Transmittal Letter in the *Community Recreation Fund* section.

Business License Tax

In November 2005 Sunnyvale voters approved a gradual increase to the City's Business License Tax rates. The increase will take place over a two-year period from FY 2006/2007 to FY 2007/2008. At full implementation, it is anticipated the increase will generate approximately $800,000 in additional revenue to a current base of $200,000 for a total of $1 million in business license tax revenue annually. Future year projections assume a 3% growth at the new $1 million base. These additional revenues are reflected in our projections for Business License Tax in the Long Term Financial Plan.

Library Audiovisual (DVD) Fees

As part of the City's budget reduction mandate for FY 2003/2004, the Library proposed a new fee to cover rental of their DVD collection. Annual revenues from this source were estimated to be $300,000, with costs of $63,000. This new business venture began in FY 2004/2005. During FY 2005/2006, it became apparent that the revenues realized would be substantially less than originally estimated. The Library therefore revised the ongoing estimates and made reductions in their operating budget to make up the net difference. The recommended FY 2006/2007 Budget includes the revised expenditure and revenue estimates for FY 2006/2007 and beyond. However, the Library has submitted a Budget Supplement which proposes that the DVD rental charges be eliminated starting FY 2006/2007. In place of the DVD rental revenue, Library staff is recommending a series of operating cuts in the same amount. Details of the Library proposal are included in the *Budget Supplements* section in *Volume I* of the recommended FY 2006/2007 Budget.

Real Property Sale

During FY 2004/2005 Council reviewed the City's real property assets and gave staff preliminary direction to sell excess City land that is not needed for future use or development. Action on the sale of land, however, was deferred pending completion of the Open Space Sub-element of the General Plan. This Sub-element was completed during FY 2005/2006. Staff is recommending that the sale of certain properties be included in the recommended FY 2006/2007 Long Term Financial Plan.

The first of these is the sale of four residential properties in the downtown area on the block bordered by Charles, Iowa, Mathilda, and McKinley Avenues. These parcels were acquired in 1998 and 1999 by the General Fund to assist possible redevelopment efforts. These properties are programmed to be sold for a total of $2.8 million in FY 2010/2011 following the reconstruction of the Town Center Mall. These properties generate approximately $70,000 in rental revenue and $15,000 in expenses each year. The associated revenues and expenses have been removed from the Long Term Financial Plan after the projected sale.

The second property recommended to be sold is the Unilever Margarine Plant at 1484 Kifer Road. This facility was donated to the City in 1979 by the Fifth Matador Corporation as a tax consideration and leased back to the company at $27,700 annually until 2017. At that time, Unilever has the option of buying the property at market price or it reverts to City ownership. In any case, it is projected that the property will be sold in FY 2017/2018 at a fair market value of $21 million.

Finally, during FY 2006/2007 staff will be studying the Raynor Activity Center facility for possible reconfiguration or disposition. The 2005 Open Space and Recreation Sub-Element identifies a Key Initiative to evaluate how the Raynor Activity Center meets open space and recreation priorities and determine what should be done with the site (e.g., keep for use as recreation facility; tear down and use for civic, non-recreation use; sell). The Open Space and Recreation Sub-Element also identifies the Raynor Neighborhood Planning Area as one having the most park acreage per 1,000 population, and it ranks as second overall for acreage per 1,000 population when both park and school acreage is considered and these factors will be also be considered in the proposal to keep or sell the old school buildings.

This Center was previously a school and was purchased by the City from the Santa Clara School District in 1980. It is comprised of eight single story buildings used by a large childcare facility, the philatelic society, and several artist studios. The Center is also used by the City's Facilities Management Division for storage. Only a portion of the Center is available for rent due to the poor condition of the buildings, which were constructed in 1962. Substantial infrastructure repairs will be required in the near future if the Center continues to operate.

Currently, revenues generated by the Center come primarily from the childcare provider and are approximately $120,000 per year. Expenses for the Center are approximately $124,000 annually. Staff will evaluate the best financial options regarding the disposition of this property when the Childcare Lease expires in January 2009. The estimated market value of this site is approximately $16 million if used for housing. No proceeds from this sale have been included in the Long Term Financial Plan pending staff review.

In keeping with the policies included in the Fiscal Sub-element of the General Plan, it is proposed that the proceeds of the land sales discussed above be utilized for one-time purposes rather than for recurring operations. The proceeds have been placed in a Reserve for Capital Improvement Projects in their respective funds.

Transfers from Other Funds

Revenues in this category for FY 2005/2006 reflected a one-time transfer from the Park Dedication Fund to reimburse the General Fund for certain park-related infrastructure expenditures. Projections from FY 2006/2007 forward are primarily for certain administrative costs provided to the Redevelopment Agency and Asset Forfeiture support of juvenile diversion activities in the Department of Public Safety.

Additional Sales Tax from Redevelopment of Town Center Mall

Another revenue that was included in the Fiscal Strategies used to balance the FY 2004/2005 Budget was additional Sales Tax, net of any additional costs, to be generated from the redeveloped Town Center Mall. It is anticipated that this revenue will be approximately $1 million per year. Last year's Long Term Financial Plan shows these funds beginning halfway through FY 2007/2008. For FY 2006/2007 staff has revised this projection to be one year later in order to reflect the current development schedule.

General Fund Expenditures

Table V, below, outlines the recommended expenditures for the General Fund only. Looking at just the General Fund, the proposed operating expenditures for FY 2006/2007 are 4.54% above the revised FY 2005/2006 Budget. It is important to note that there are several transfers from the projects expenditures and other Funds that are not new costs but have been reallocated for better accounting and management oversight. These items are detailed below. If these transfers are removed and the comparison is made with the same base as in last year's budget, the increase is 3.53%.

Including the Budget Supplements, the operating expenditures are up 7.74% above the revised FY 2005/2006 Budget. Total General Fund recommended expenditures, including projects, debt service, and equipment are 5.82% above the revised FY 2005/2006 Budget.

Table V Recommended Expenditures – General Fund

Expenditure Character	2004/2005 Actual	2005/2006 Revised Budget	2006/2007 Recomm. Budget	% Growth 2006/07 over 2005/06	2007/2008 Proposed Budget	% Growth 2007/08 over 2006/07
Operating	96,275,709	103,666,796	108,369,637	4.54%	110,409,189	1.88%
Budget Supplements			3,318,840		4,671,615	
Project Operating	0	0	22,791		36,476	
Projects (1)	2,379,443	1,294,309	664,528	-48.66%	381,635	-42.57%
Project Carryover		1,420,521				
Debt Service	411,323	410,138	412,778	0.64%	408,969	-0.92%
Lease Payments	1,212,208	1,210,558	1,212,920	0.20%	1,213,805	0.07%
Equipment (2)	0	300,000	100,000		0	
Service Level Set-Aside			500,000		510,000	2.00%
TOTAL	**100,278,683**	**108,302,322**	**114,601,494**	**5.82%**	**117,631,689**	**2.64%**

(1) Projects includes project costs and project administration costs.
(2) The FY 2005/2006 appropriation for General Fund Equipment is $300,000, of which $100,000 is expected to be expended in FY 2005/06 and the remaining $200,000 will be carried over to FY 2006/2007.

The major changes in the operations component of the General Fund are highlighted below:

Three Special Projects were moved into operations because they are ongoing functions provided by the General Fund. These were:

- Project Sentinel Dispute resolution services ($104,000) are now included in the Community Development Department budget
- Congestion Management Agency participation costs ($250,000) are now included in the Public Works Department activities
- Ongoing costs for property management services ($300,000) are now included in the Public Works Department budget

A number of changes have been made to the manner in which Human Resources functions are accounted for. These include approximately $1.7 million in administrative costs moved from the Employee Benefits and Insurance Fund to the General Fund. It should be noted that this is simply a change in accounting and not a net cost increase to the City overall.

Services in the Human Resources Department increased in the following areas:

- Additional staffing to ensure that service levels are met: $236,000
- Enhancement of recruitment, labor relations, and training functions: $209,000
- Supplemental funds for expected increased recruitment activities over a three year period from FY 2006/2007 through FY 2008/2009:$188,000 annually. These funds are not ongoing and have been reduced from the Long Term Financial Plan starting in FY 2009/2010. In addition, a reduction in one full-time position has been budgeted starting in FY 2009/10 in anticipation of better management and efficiencies in recruitment and other Human Resources Department activities.

FY 2006/2007 is an off year for City elections and the Office of the City Manager budget for election-related costs has been reduced accordingly: $400,000.

The Light Duty program for Public Safety sworn employees has been moved from the Employee Benefits and Insurance Fund to the Public Safety budget in the General Fund to provide better management oversight: $392,000

Costs of employee benefit additives for Public Safety employees have been reduced to reflect new retirement and worker's compensation rates: $1.4 million

Each year the Gas Tax Fund supports a large portion of the Public Works Pavement Operations program. The amount that is used for this purpose varies each year depending upon funds available and project requirements. In FY 2005/2006 the Gas Tax support amounted to $3.9 million. For FY 2006/2007 the use of Gas Tax has been reduced to $2.2 million.

Additional retirement contributions for miscellaneous employees due to expected enhanced retirement formula in FY 2007/2008: $800,000.

Variable costs for Public Safety recruitment and training for new sworn officers have been moved to a Special Project for better fiscal control: $2.2 million. These funds will be reflected in Budget Supplement No. 10, discussed below.

Budget Supplements

For the recommended FY 2006/2007 Budget, eight budget supplements are proposed for the General Fund. The City Manager recommends that seven of these supplements be included in the adopted budget. The total annual impact of these supplements is $3,288,016, and the twenty-year impact is $79,583,863.

Additionally, supplements proposed for the Community Recreation Fund and the General Services Fund have a significant financial impact on the General Fund. Two budget supplements have been proposed for the Community Recreation Fund, with both recommended by the City Manager for funding. One supplement has a one-time cost increase of $40,000. The other supplement details the various revenue and expenditure measures that the Community Recreation Fund will be undertaking to eliminate their financial gap going forward.

One supplement has been proposed and recommended by the City Manager for the General Services Fund, to be funded in FY 2007/2008. The total annual impact of this supplement is $42,003, and the twenty-year impact is $548,592.

Budget Supplement No. 10 is of particular note because of its size and complexity. In brief, the Department of Public Safety is proposing to move the majority of existing funds for recruitment, selection, and training of new officers out of the General Fund operating expenditures and fund these costs through Special Projects for better accounting and monitoring. The administration and overhead costs for recruitment, selection, and training of new officers will remain in the General Fund as operating expenditures, and DPS has committed to reducing this overall operating expenditure during FY 2007/2008.

For FY 2006/2007, the Department of Public Safety is requesting a total of $3,887,530 to fund recruitment, selection, and training. This consists of $3,222,084 for three Special Projects to hire 21 officers and $665,446 in fixed operating costs. The current budget included $2,341,379 for FY 2006/2007, resulting in a net fiscal impact of $1,546,151. The estimated cost over the next twenty years for recruitment, selection, hiring, and training of Public Safety Officers is a total of $94 million. This includes $79 million in special project costs and $15 million in operating costs. Accounting for the current funding included in the adopted FY 2005/2006 Budget of $63 million, the total twenty-year fiscal impact is $31 million. This funding provides for 266 recruits, yielding 221 successful hires, over the twenty years. The City Manager is recommending that this supplement be approved.

Moving the direct operating expense into Special Projects instead of maintaining the entire cost of these activities in the operating budget has several advantages. The most important of these is that it allows expenditures to fluctuate each year, dependent on the number of required recruitments. It also allows the expense for each set of recruiting classes to be tracked separately instead of being consolidated into one operating budget. This provides better tracking and monitoring of expenses related to each recruitment. Additionally, it separates direct and indirect costs for these activities. Total indirect costs, including administration and overhead, remain in the operating budget, while direct costs for each recruiting class are budgeted and expended from separate Special Projects. Similar to the first advantage, this creates better visibility to expenditures and allows for comparison across projects.

Detailed reports for all budget supplements are located in *Volume I* of the recommended budget document.

General Fund Projects

This is the second year of the two-year budgeting cycle for projects. Therefore, staff efforts were limited to review of newly proposed projects and those that had changed significantly in scope or cost. By and large, the General Fund projects contained in last year's Resource Allocation Plan have experienced few changes in timing, cost, or scope. This Transmittal Letter focuses on newly developed or significantly revised projects. Descriptions and detailed financial information on all projects can be found in the budget document, *Volume III, Projects Budget*. There are two helpful indexes of all the City's projects, one by project name and the other by project number.

The recommended FY 2006/2007 Budget for the General Fund includes $50,000 in Capital Projects, $344,295 in Special Projects, and $100,000 in Outside Group Funding Projects. Additionally, General Fund-related projects are found in several places in the budget. They are in the General Fund, the Gas Tax Fund, the Capital Projects Fund, and the Infrastructure Renovation and Replacement Fund. These latter categories are considered to be related to the General Fund because it is the ultimate source of financial support through contributions or transfers. The recommended FY 2006/2007 Budget includes $670,501 in transfers from the General Fund to the Infrastructure Renovation and Replacement Fund. *Volume III, Projects Budget* contains details on the projects included in the Infrastructure and Capital Projects Funds in the recommended FY 2006/2007 Budget.

Several major capital or special projects have been discussed earlier in this Transmittal Letter in the *Major Project Efforts* section. The following are additional projects affecting the General Fund which are either new or have changes in funding in the recommended FY 2006/2007 Budget:

- **City Owned Properties - Downtown:** This project provides funds to maintain seven properties that the City owns in the downtown area. These properties include two single family residences, the building leased by the Chamber of Commerce, a duplex and two vacant lots. It is projected that the City will dispose of the residential and vacant parcels in FY 2010/2011 at an estimated sales price of $2.8 million. The General Fund previously owned a third single family residence at 388 Charles Street, which was sold to the Housing Fund in FY 2005/2006.

- **Downtown Underground Parking Insurance:** On November 15, 2000, the City entered into a Declaration of Covenants, Conditions, and Restrictions (CC&R)

with M-F Downtown Sunnyvale, LLC ("Mozart"), wherein it was agreed that Mozart would purchase an "all risk" property and casualty policy covering the improvements, (which included our portion of the underground parking structure) for both the City and Developer, with Mozart paying 75% of the premium, and the City repaying Mozart for the remaining 25%. This project provides the City's annual obligations of $45,000.

- **NOVA Youth Employment Program**: This project provides $21,064 in FY 2006/07 and $21,485 in FY 2007/08 to assist Sunnyvale youth between the ages of 14 and 24 with various job-related activities. These include career exploration, job referrals, job search and retention strategies, and volunteer and internship opportunities. Previously, this program was funded through a transfer from the Community Recreation Fund to NOVA. As of FY 2006/2007, NOVA will receive funding directly through the General Fund.

- **Joint-Venture: Silicon Valley Network:** Joint-Venture: Silicon Valley Network is a non-profit organization working to promote economic vitality and quality of life in the greater Silicon Valley region. The specific mission is to promote Silicon Valley as a good place to do business to retain jobs and create jobs. Joint-Venture is a unique partnership of business, government, education, and community leaders. Local funds are used for promotional programs. Private sector funding also supports Joint Venture. The City's current contribution of $5,000 represents an 80% reduction from the $25,000 annual contribution the City has made in the past. The City's contribution was first reduced to $10,000 in FY 2003/2004, then to $5,000 in FY 2004/2005 due to ongoing budget issues. Staff recommends continuing the contribution of $5,000 for FY 2006/2007.

General Fund Reserves and Set-Asides

One of the most powerful aspects of multi-year financial planning is its capability to recognize trends over time and begin at an early point to consider the necessary steps to alter the long-term forecasted position of a particular fund should that appear necessary. The reserves and set-asides contained in the General Fund's Long-Term Financial Plan play a pivotal role in the City's multi-year planning strategy.

The City has established reserves in the General Fund that are restricted by prior policy or legal requirements to specific uses. Most of the City's reserves are established in accordance with policy adopted in the Fiscal Sub-element of the General Plan. <u>Policy 7.1B.8:</u> states:

> "<u>Reserves</u>: Provide a prudent level of reserves for future unexpected expenses and revenue declines; to accumulate funds to support future planned capital improvements, and to level high and low expenditure years in the Ten-Year Resource Allocation Plan."

The General Fund currently has four reserves that are designed to be used according to the policy above. These reserves are contained in the General Fund's Financial Plan under the sub-heading, *Reserves*.

The first is the *Contingencies Reserve* equal to 20% of the operating budget each year. This reserve is to be used only in case of emergency or disaster, and is not intended for normal unanticipated expenditures. In the Fiscal Sub-element, the policy calls for this reserve to be 10% of operations, but Council policy adopted in FY 1992/1993 changed it to 20% of operations. This reserve changes each year as operations of the General Fund either increase or decrease.

A second reserve in the General Fund is entitled the *20-Year Resource Allocation Plan (RAP) Reserve.* This reserve functions to levelize economic cycles from year to year. By letting this reserve vary each year, the fund can absorb the cyclical effects of the economy and specifically plan for project-related expenditures. In essence, this reserve grows during periods of economic growth and is drawn down during the low points of economic cycles to maintain stable service levels. The *20-Year RAP Reserve* functions very effectively to prevent us from adding services at the top of the economic cycle that cannot be sustained while allowing us to maintain Council-approved services levels during economic downturns.

The function of the *20-Year RAP Reserve* and its strength has been particularly apparent when the City struggled with the rapid economic downturn resulting from the Dot.com bust. In prior years when the City was experiencing strong economic growth, the reserve was building up over time to the $61 million level reached in FY 2002/2003. Then, as the effects of the economic downturn began to be fully felt, the reserve was available to provide a “cushion” to maintain City services at desired levels. In the recommended FY 2003/2004 Budget, a structural imbalance between revenues and expenditures of $15 million was identified, and a plan consisting of a combination of service level/expenditure reductions and fee increases was implemented to bring the General Fund into balance over the twenty-year planning period. The recommended FY 2006/2007 Long-Term Financial Plan shows the *20-Year RAP Reserve* being drawn down until FY 2011/2012 when it gradually begins increasing.

A detailed discussion of our current projections for the 20-Year RAP is found in the section below entitled *General Fund Fiscal Position.*

The third reserve in the General Fund is the *Reserve for Capital Improvement Projects.* Originally entitled the *Land Acquisition Reserve,* it was established in FY 1994/1995 for the purpose of purchasing land or property in the downtown area with an emphasis on future income generation through economic development. In the past, it was used to purchase key parcels in the downtown area. In the Adopted FY 2005/2006 Budget the reserve level is $550,000 to reflect the addition of proceeds from the land sale of a property on Charles Street to the Housing Mitigation Fund. The reserve increases throughout the Long Term Financial Plan as several of the City’s land assets are sold.

The final reserve is *the Set Aside for the Historical Museum* in the amount of $20,000. When Council approved an appropriation for construction of the Sunnyvale Historical Museum, an allocation of $20,000 was also approved to help defray operating expenses in the first five years. This money has been set aside pending actual construction and opening of the Museum.

In prior years the General Fund also has had an additional 5% of operating costs in the *Service Level Stabilization Reserve.* This reserve was established in FY 1993/1994 to provide funds for increased service levels or costs in excess of inflation. Before FY 1993/1994, the Resource Allocation Plan contained an on-going set-aside called the "One Percent of Operations Set-aside" that provided the ability to handle revenues that did not perform as well as projected and expenditures that increased more than inflation. This set-aside was replaced by the *Service Level Stabilization Reserve*.

In the Adopted FY 2005/2006 Budget the *Service Level Stabilization Reserve* was removed from the General Fund Long Term Financial Plan. This reserve was replaced by an on-going *Service Level Set-Aside.* This set-aside represented funds that would be available to increase service levels or add new services. In last year's Financial Plan no funds were available in the *Service Level Set-Aside* until the end of the first ten years because of the City's ongoing financial difficulties. For the recommended FY 2006/2007 Long Term Financial Plan $500,000 annually has been added to the *Service Level Set-Aside* beginning in FY 2006/2007. It is important to note that a reserve is one-time, and once drawn down it is gone. The set-aside, on the other hand, is available each year for ongoing purposes.

Another reserve that the General Fund has had in the past is the *Non-Recurring Events Reserve.* This reserve contained funds from FY 1997/1998 and FY 1998/1999 that resulted from greater than anticipated revenues and lesser than anticipated expenditures during the height of the dot.com boom. By Council action, these types of one-time funds resulting from the peak of the economic cycle were set aside and used for significant high-priority capital and special projects and not used to add recurring services. This reserve was eliminated in the Adopted FY 2005/2006 Budget.

In past years the General Fund Long Term Financial Plan has contained a planned expenditure called *Fiscal Uncertainties.* The *Fiscal Uncertainties* line item was contained within the *Expenditures* section of the financial plan, and it represented the on-going latitude that was available to increase service levels, add new annual programs, or address unexpected fiscal pressures. For the recommended FY 2004/2005 Budget the *Fiscal Uncertainties* line item was zeroed out for the first nine years of the plan and in the recommended FY 2005/2006 Budget this line item was eliminated. As discussed above, this line item has been replaced by the *Service Level Set-Aside*, which provides flexibility to add services while maintaining existing service levels.

General Fund Financial Position

The City has made considerable progress toward its goal of long term financial stability during this past year. The recommended FY 2006/2007 Long Term Financial Plan is balanced over the full twenty years with no additional service level reductions required.

Last year, the FY 2005/2006 Budget and Long Term Financial Plan for the General Fund included several *Fiscal Strategies* that were designed to address the ongoing structural gap between revenues and expenditures. Even with these fiscal strategies included, the General Fund Long Term Financial Plan still required an additional $1.1

million in ongoing decreases in expenditures or increases in other revenues in order to balance over the first portion of the planning period. This amount was reflected in the line item *Fiscal Strategies* contained in the *Expenditures* section of the Plan.

During FY 2005/2006, staff continued to implement cost saving strategies to address the structural gap. Additionally, Council successfully pursued two tax increases. In November 2005, Sunnyvale voters approved increases to the City's Transient Occupancy Tax and Business License Tax rates, which were lower than those of most of our surrounding communities. These two revenue increases provided additional resources to address our ongoing fiscal challenges.

As a result of these efforts and the improving economic climate, the recommended FY 2006/2007 Budget does not require any further service reductions. In fact, since FY 2003/2004 the Council has restored certain services. Further, significant service level additions are recommended for consideration through the Budget Supplement process. The *Service Level Set-Aside* has been funded at approximately $500,000 annually on an ongoing basis, and the *Capital Improvement Project Reserve* has been increased substantially. Finally, the General Fund subsidy to the Community Recreation Fund has been increased to support all of the services that the Council and the community believe are important to our quality of life.

In spite of this greatly improved economic picture, Sunnyvale does face a number of challenges to its long term financial stability in the upcoming years. These include: Library facilities and programming needs; the need for Civic Center replacement or renovation; rising employee costs and the need to invest in our workforce; and unfunded capital projects.

The visioning exercise recently completed during FY 2005/2006 indicated that our Library facility and collection are not keeping up with the growing demand for our services. This may result in a need for substantial new services or facilities in the near future. Although a portion of the capital costs may be funded through State bond proceeds, significant operating costs will be required to support the future vision for the Library.

An additional challenge to the General Fund's long term fiscal health is the unfunded capital and infrastructure projects that have been identified through the budget process. Of particular concern is the unfunded Civic Center project which anticipates the need to reconstruct or renovate the existing City Hall complex due to functional obsolescence and significant maintenance and repair costs.

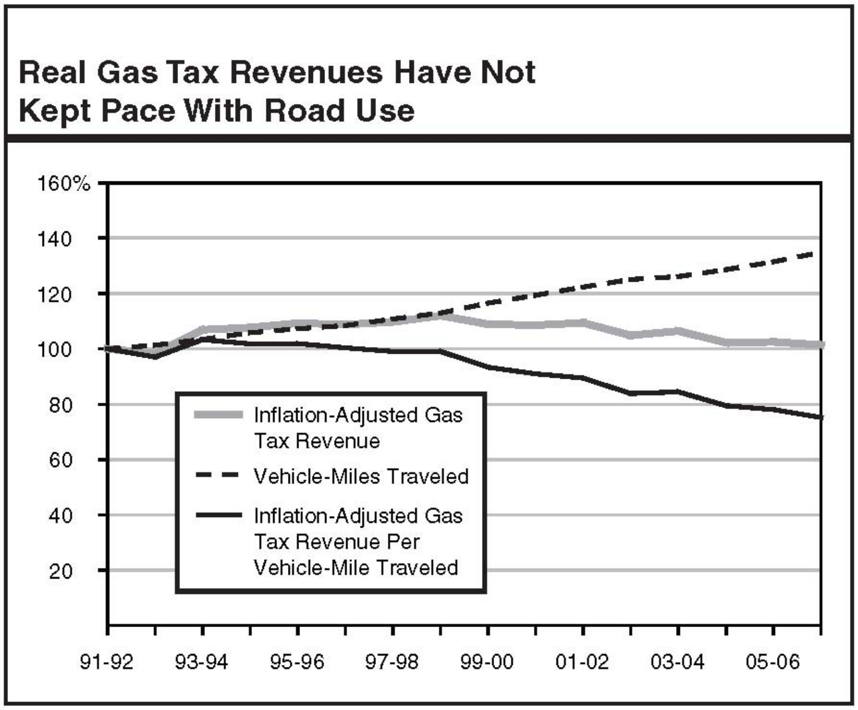
Finally, the cost for employees, both in salaries and benefits, has increased significantly in the last several years. In order to maintain the quality of life that the community expects, the City needs to function as a high performing organization, leveraging opportunities as they arise. As with any world class organization, it is important we attract the best candidates that show the passion for public service and are committed to doing their best in delivering the highest quality service in the most cost effective manner. In order to continue to be a high performing organization, we need to invest in our human resources, providing opportunities for learning, encouraging skills and professional development, and providing the tools necessary to function at optimum levels. We also need to continue to evaluate staffing needs, create a learning environment for employees to compete for promotional opportunities, and prepare employees to meet future challenges.

Sunnyvale's Planning and Management System provides the foundation upon which to make informed policy decisions in support of the City's core mission. During this past year staff has undertaken an ambitious program to completely restructure our performance budgeting structure. Work included evaluation of the philosophy and intent of the system as well as the process. Recommended changes to the performance based system were brought to the Council and have been incorporated into the recommended FY 2006/2007 Budget.

The recommended FY 2006/2007 Budget for the General Fund continues to reflect Sunnyvale's new fiscal reality. At the bottom of the General Fund Long Term Financial Plan, the difference between total current resources and total current requirements is calculated. As the calculation indicates, current requirements are greater than current resources for the first five years and for four of the last five years of the Long Term Financial Plan. Over the twenty years, total current resources are $11.4 million higher than total current requirements without the *Service Level Set-Aside*. While this does indicate there are enough current resources to cover current requirements, it is a very small margin. Given the many fiscal pressures and challenges the City faces, the margin can quickly turn the other direction.

Gas Tax Fund

The Gas Tax Fund is required by State law to account for gas taxes collected and allocated by the State. These taxes are levied on gasoline and other motor fuels as a flat eighteen cents per gallon, and these funds are then distributed to the State, cities and counties on a formula primarily based on population. As discussed previously in the *Traffic and Transportation Funding* section of this Transmittal Letter, these revenues do not keep pace with inflation. A recent report issued in February 2006 by the State Legislative Analyst entitled Funding for Transportation Programs included the table on the next page which illustrates the erosion of gasoline taxes over time.



Additionally the share of Gas Taxes that Sunnyvale is allocated has declined slightly as population growth in other areas of the state outpace our growth rate. To reflect these changes, Gas Tax revenues have been projected at approximately $2.4 million each year throughout the twenty-year plan.

In accordance with state law, the Gas Tax Fund receives interest earnings on any unspent cash balances. Gas Tax funds are spent on maintenance and capital related to public streets and highways. As noted in the previous discussion of the General Fund, the Gas Tax Fund works in tandem with the General Fund. Essentially, a level of Gas Tax funding for operations is established, with remaining funds used to cover Gas Tax-eligible capital projects.

Operating expenses programmed for street maintenance in this fund are $2.2 million for FY 2006/2007 and $2.25 million for FY 2007/2008. For the remainder of the first ten years, operating expenses vary from $1.85 million to $2.5 million each year. Operating expenses covered by the Gas Tax Fund are lower in the second ten years.

The recommended FY 2006/2007 Budget for the Gas Tax Fund has two capital projects totaling $82,148. The first is a continuing project in the amount of $20,000 annually plus inflation for the City's share of development costs associated with streets and roadways. The second project provides $62,148 for sidewalks on Java Drive funded by a transfer from the Transportation Development Fund.

The project administration expenditure in the Gas Tax Fund represents the in-lieu charge for Engineering Services that are expected to be utilized in supporting capital projects that are funded directly from the Gas Tax Fund.

Finally, the recommended FY 2006/2007 Budget reflects a transfer to the Capital Projects Fund/Gas Tax Sub-fund of $312,970 to support the Roadway Rehabilitation on Various Streets project in the amount of $122,462 and provide $190,508 for the project administration costs associated with Gas Tax related projects in the Capital Projects Fund.

Beginning in FY 2001/2002 new state funding for streets and road systems, the State Traffic Congestion Relief Program (TCRP) has been held and accounted for in a Sub-fund of the Gas Tax Fund as required by State law. A complete discussion of this revenue source and the projects associated with it can be found in the *Transportation Funding Issues* section of this Transmittal Letter.

ENTERPRISE FUNDS

The Enterprise Funds of the City incorporate programs and activities that are either fully self-supporting by way of user charges and fees or partially self-supporting. Those that are partially self-supporting require some level of transfer from the City's General Fund.

The City has three utilities that are fully self-supporting, including the Water Supply and Distribution Fund, Solid Waste Management Fund, and Wastewater Management Fund. Additionally, the SMaRT Station® Fund has been established to account for operations at the Sunnyvale Materials Recovery and Transfer Station, which is a partnership among the three cities of Sunnyvale, Mountain View and Palo Alto. This fund consists of two sub-funds, one used to account for SMaRT Station operations and the other used to account for equipment replacement needs.

In April 2006 Council approved the following rate changes effective with the billing cycle on or after July 1, 2006:

Utility	Rate Change
Wastewater	6.0%
Water	11.5%
Solid Waste	5.5%

Each rate increase and the factors contributing to the need for such increases are discussed in detail below. As a result of these increases, monthly costs associated with solid waste, water, and wastewater services for an average residential customer will increase by 7% overall. It is important to note that even with the rate changes, Sunnyvale residents enjoy utility rates that are approximately 25% lower than the average of surrounding communities. This amounts to annual savings of approximately $317 per household. Commercial customers also enjoy rates that are competitive with surrounding communities.

There is one enterprise fund that requires an annual transfer from the General Fund for operations because it is not fully sustaining. The Community Recreation Fund incorporates Leisure Services activities including golf, tennis, and recreation programs.

Water Supply and Distribution Fund

The Water Supply and Distribution Fund accounts for all revenues and expenses related to the City-operated water utility. Expenses include costs for wholesale water, project-related costs, debt service, and other operating costs. Revenues consist of service fees for water and recycled water, water-related public works and construction fees, and interest income. Once expenditure levels are developed, then water rates must be set to maintain the fund in a sustainable financial position. The fact that Sunnyvale utilizes long-range financial planning and sets utility rates every year helps minimize wild rate swings.

Sunnyvale currently receives water from four different sources. For FY 2006/2007, approximately 41% is projected to come from the Hetch Hetchy system operated by the San Francisco Public Utilities Commission (SFPUC), 45% from the Santa Clara Valley Water District (SCVWD), 7% from well water, and the remaining 7% from recycled water.

A significant portion of the Water Fund's direct expenditure budget is the cost of purchased water (currently 71% and projected to be 80% within ten years), so each year staff reviews the costs of wholesale water and the quantities planned to be purchased. Currently for FY 2005/2006 the City is paying the SFPUC $444 per acre foot plus meter charges of $267,000, for a total of $468 per acre foot. Current charges for SCVWD purchased water are $420 per acre foot plus a $90 treated water surcharge, for a total of $510 per acre foot. The forecast anticipates costs for FY 2006/2007 of $519 per acre foot plus meter charges for SFPUC water for a total per acre foot of $544. This represents a 16.2% increase over last year's cost. The forecast for SCVWD is $535 per acre foot for water purchased from SCVWD, including the water surcharge, for an increase of 4.9%.

The City also receives charges in the form of a pump tax from the SCVWD for pumping ground water from City wells. The unit cost for well water is also influenced by the power costs associated with running the pumps. The projected well water total unit cost (tax plus power) for FY 2006/2007 is $520 per acre foot, an increase of 3.4% over last year's unit cost of $503.

Finally, the City's Water Pollution Control Plant provides recycled water as part of the Water Reclamation Project begun in 1993. Recycled water is wastewater that has been treated to very high standards. Recycled water currently provides landscaping water for the Sunnyvale Municipal Golf Course, Baylands Park, Twin Creeks softball complex, the SMaRT Station, and several commercial businesses in the Moffett park commercial/industrial area. The cost for recycled water is borne by both the Water Supply and Distribution Fund and the Wastewater Management Fund. The Water Supply and Distribution Fund distributes and sells recycled water and benefits through reduced reliance on potable water sources. The Wastewater Management Fund produces recycled water and benefits from the resulting diversion of wastewater from discharge to the San Francisco Bay.

In addition to the benefits provided by recycled water discussed above, the City receives a $115 per acre foot rebate from the SCVWD to encourage its use of recycled water. The SCVWD provides this benefit on the premise that the use of recycled water reduces strain on potable water supplies. The rebate is based upon a contractual agreement between the City and the SCVWD entered into in 1997. The original contract envisioned a 25 year period of rebates with renewal at five year increments. However, SCVWD is considering alternative ways to fund recycled water and the City's current contract only has two years remaining, ending in FY 2007/2008. Information from SCVWD staff indicates that the District will not be renewing the contract. Staff is maintaining a dialogue with SCVWD regarding this issue, and hopes to continue to receive some form of financial subsidy for the production and distribution of recycled water. The projected Long Term Financial Plan for the Water Supply and Distribution Fund includes the presumption that we will continue to receive the rebate or some other form of recycled water incentive throughout the full twenty years. Should this not occur, the negative impact on the Fund would be $195,500 per year.

The first step in setting rates for the Water Supply and Distribution Fund is completion of a Twenty Year Water Production Forecast. This analysis looks at the total amount of water that will be needed for the next twenty years, taking into account demand trends, water conservation, growth and projections of population. The water usage projection had previously been based upon a build out plan for the City developed in the 1980s. Review this year indicates that the build out plan may overestimate the amount of water required by Sunnyvale over the long term. Actual purchase and sales of water have been relatively flat over the past few years, due to slower population growth, water conservation, success of the recycled water system, and wet weather conditions. To reflect these various factors, the Twenty Year Water Production Forecast has been developed to reflect a modest increase for FY 2006/2007 in water usage and flat water sales into the future.

To complete the purchase analysis, staff looks in detail at each source of water supply. Staff obtains projections from each of the City's water wholesalers for the next year and longer term. The projections received from SCVWD have been fairly stable, while the SFPUC rates have varied significantly from prior year projections.

Staff also receives information on potential SFPUC rate increases from the Bay Area Water Supply and Conversation Agency (BAWSCA). BAWSCA is the agency which represents the "Suburban Users", a group of water retailers outside the City of San Francisco. Sunnyvale is one of 28 jurisdictions outside of the City of San Francisco who account for approximately 70% of the water supplied by the SFPUC's regional water system.

Staff takes the numbers provided by the water wholesalers, factors in all known price increases, and projects water usage over the long-term plan to optimize the use of the least expensive sources of water within the terms of each contracts.

The recommended FY 2006/2007 Budget includes the projections provided by SFPUC and BAWSCA and the SCVWD through FY 2015/2016, with one exception. For FY 2008/2009, SFPUC staff projected a reduction in wholesale water rates. Sunnyvale staff instead reflected a 3% increase in that year and then smoothed the increase for FY 2009/2010 to reach their new stated rate for FY 2010/2011. Staff believes that this is prudent in light of the large rate increases that SFPUC has actually experienced historically.

The projections provided by each agency are as follows:

	SFPUC	SCVWD
FY 2006/2007	16.2%	4.9%
FY 2007/2008	5.5%	2.8%
FY 2008/2009	7.4%	3.6%
FY 2009/2010	7.1%	5.3%
FY 2010/2011	19.2%	3.3%
FY 2011/2012	23.8%	3.2%
FY 2012/2013	27.7%	4.7%
FY 2013/2014	26.9%	3.7%
FY 2014/2015	3.3%	3.6%
FY 2015/2016	4.6%	4.9%

As the table above indicates, SFPUC has projected a 16.2% overall increase in purchased water costs for FY 2006/2007. This large rise in cost is due to several factors, including slumping revenues that resulted from a wet year (when people use less water for irrigation) combined with unexpected increases in Operations and Management.

Wholesale water purchased from SCVWD is projected to rise 4.9% for FY 2006/2007. This is the same increase projected last year. In recent weeks, City staff has gotten some indication that SCVWD rates could rise more substantially in order to fund additional operations and capital costs and an increase in discretionary reserves. However, based on the current financial position of the SCVWD, City staff believes that the lower rate forecast is the more realistic alternative.

The new projections for wholesale water prices in FY 2006/2007 cause SFPUC to change from being the less expensive wholesaler to the more expensive beginning in FY 2006/2007. This will affect the amount of water we project to purchase from SFPUC since our policy is to maximize purchases from the least expensive source. For FY 2006/2007 we are projecting to purchase 10,529 acre feet from SFPUC, representing our contractual minimum. Purchases from SCVWD will go up to 11,471 acre feet.

The remaining 30% of direct operating costs of the Water Supply and Distribution Fund are related to City activities involved in operating and maintaining a water supply and distribution system. The system includes ten storage reservoirs and approximately 280 miles of transmission and distribution mains. Other activities include management of the wholesale water contracts, effective utilization of conservation programs, recycled water and City-owned wells, and ensuring that all water delivered meets quality and health standards. The recommended FY 2006/2007 Budget includes a modest increase of 1% from last year's budget in operations. It should be noted that the actual estimated operations expenditures for FY 2005/2006 are significantly lower than budgeted because of lower costs for gas and electricity and staff vacancies.

The Water Supply and Distribution Fund contains annual debt service of approximately $1.1 million through FY 2018/2019 for Water and Wastewater Revenue Bonds. These Bonds were originally issued in 1992 to fund the recycled water system and were refunded in 2001 to reduce debt service costs. Debt service also includes the Water Fund's portion of the Certificates of Participation issued in 2001 for purchase of the 505 West Olive Government Center property. This debt service, in the amount of about $87,000, continues through the Twenty Year Financial Plan.

Over the past few years, Sunnyvale staff has been working to identify and scope projects to improve the City's water supply and distribution system. $26.9 million in capital and infrastructure projects are included in the first ten years of the FY 2006/2007 Long Term Financial Plan, and $12.9 million in fully identified water infrastructure and capital projects are included in the second ten years of the plan. Public Works staff have proposed a methodical and measured repair and rehabilitation plan for the water supply facilities with the goal of extending infrastructure life by up to 100 years.

Following are the capital and infrastructure projects recommended for funding in FY 2006/2007:

- **Refurbishment of Water Tanks at Wright Avenue:** This project provides $100,000 in funding for FY 2006/2007. A total of $3,197,364 is budgeted over the seven year period through FY 2012/2013 to refurbish the two water tanks located at Wright Ave., inside and out, in accordance with a complete structural and coating evaluation done in 2004. Refurbishing the tanks is more cost-efficient than replacing them, and proper coating with the normal schedule of periodic tank maintenance should keep the tanks in useable condition for up to 40 years.

- **Water Main Development Costs (City Share):** This project provides ongoing funding of $20,000 per year plus inflation to pay for the City's share of water mains constructed by private developers. The Sunnyvale Municipal Code requires that costs be shared by the City when the developer is required to provide water mains in excess of eight inches.

- **Water Pipes, Manholes, and Laterals Replacement:** This project provides ongoing funding of $20,000 annually plus inflation for miscellaneous small water projects that may arise unexpectedly. Generally, funding is used for emergency repairs occurring outside normal operations.

- **Water Meters for New Developments:** This project provides $59,800 in funding per year plus inflation to purchase and install water meters for new development activities. Costs are reimbursed to the Water Supply and Distribution Fund by the end user.

- **Doublecheck Valves & Backflow Devices for New Developments**: This project provides $50,000 annually plus inflation to purchase and install detector checks and backflow devices for new development activities. Costs are reimbursed to the Water Supply and Distribution Fund by the end user.

In addition to the projects with funds appropriated in FY 2006/2007, some of the major capital and infrastructure projects included in the Water Fund's Long Term Financial Plan are as follows:

- **Central Water Plant Building Reconstruction:** The Central Water Plant is a critical element of the City's water supply system. This project will provide $1.8 million in funding from FY 2007/2008 through FY 2010/2011 to replace the existing structures and evaluate the existing equipment. Additionally, the project will provide funding to install a new propane generator, magnetic flow meter, and underground piping.

- **City-Wide Water Line Replacement:** The integrity of the City's water supply system is critical to protect public health and safety. The success of these goals is dependent on the maintenance and eventual replacement of aged and worn infrastructure. Currently, many portions of the water system have exceeded their estimated life expectancy of 35 to 40 years. This project will provide $13.5 million over the Long Term Financial Plan beginning in FY 2007/2008 to replace a total of 280 miles of water lines. Replacement will also upgrade pipes and fittings for seismic stability.

- **Interior Coating of Water Tanks:** This project funds $2.1 million to remove the interior coal tar coating of five small water tanks and three large water tanks and re-coat them to American Water Works Association standards. Approximately $600,000 is budgeted in FY 2008/2009 and FY 2009/2010 for the five small half-million gallon tanks, and the remainder of the project is scheduled in FY 2012/2013 through FY 2015/2016.

- **Earthquake Mitigation of Water Tanks:** The impact of tank failure during seismic activity is amplified by likely additional needs placed on the water system to protect public health and to provide fire suppression. This project will provide $1.9 million from FY 2008/2009 through FY 2012/2013 to anchor tanks to the ground and improve water inlet, outlet, and overflow connections by adding flexible couplets.

- **Pressure Reducing Valve Replacement and Relocation for SCADA:** Pressure reducing valves are an integral part of the water distribution system, providing balanced water pressure throughout the City. The valves are 40 to 50 years old, and the cost of preventive maintenance has begun to exceed replacement costs. This project provides $2.5 million over twenty years starting in FY 2007/2008 to replace the City's sixty existing pressure-reducing valves with new ones.

It should be noted that staff is currently evaluating the necessity and cost-benefit of maintaining all aspects of the water system infrastructure, including pipes, tanks, pump stations, and control valves and will include the results of this evaluation in the capital improvement project process beginning next year.

Engineering costs associated with management of the capital and infrastructure projects are reflected as Project Administration charges on the Long Term Financial Plan.

The Water Supply and Distribution Fund carries a loan that was advanced from the General Fund in FY 2002/2003 for an original principal balance of $1,632,000. During FY 2002/2003 the City purchased property located at 239 Commercial Street to provide additional space for the Public Works Corporation Yard. The total purchase price of $2,530,000 was funded by the City's Water and Wastewater enterprise funds based on the number of staff located at the Corporation Yard. The Water Fund's share of the cost amounted to 64%, or $1,632,000. The Water Fund did not have sufficient funds for the purchase, and the General Fund loaned the Water Fund the total amount. The loan accrues interest of 6% starting in FY 2002/2003.

The recommended FY 2005/2006 Budget reflected an accelerated repayment schedule for the Interfund Loan. The Financial Plan for FY 2006/2007 makes no change to that schedule.

The Fiscal Sub-Element of the City's General Plan calls for the Water Fund to maintain a Contingency Reserve of 25% of operations. This Contingency Reserve is to be used only in the event of disasters or other emergencies. The Water Fund also maintains a Rate Stabilization Reserve to smooth utility rates from year to year, levelize economic cycles and plan for project-related expenditures.

The rate increase approved by Council for water utility services for FY 2006/2007 is 11.5%, compared to the 4.5% anticipated last year. As stated earlier, this increase is due primarily to significantly higher charges for purchased water, particularly from the SFPUC Hetch Hetchy system. The projected rate increases anticipated over the remainder of the 20 years are shown at the bottom of the Water Fund Long Term Financial Plan.

Utility rates are intended to capture the cost of providing service to each category of customer. Because the composition of both costs and customers change over time, staff periodically updates the cost allocation methodology underlying the rates. A Water and Wastewater cost of service study is currently underway, with a draft expected by the end of this fiscal year. Elements being reviewed include changes in the tiered rate structure, allocations of cost to each customer class, and an analysis of each phase of the recycled water master plan. This study will be helpful in projecting future usage and rates for both potable and recycled water.

Wastewater Management Fund

The Wastewater Management Fund accounts for the revenues and expenses related to the City-operated sewer collection and Water Pollution Control Plant (WPCP) services.

The City owns and operates an extensive system for management of wastewater (sewage) within City limits and in a small area in northern Cupertino. The system includes approximately 327 miles of sewer pipes and a 29.5 million gallon per day (MGD) Grade V Water Pollution Control Plant. Operations include the transport of sewage to the treatment plant, wastewater treatment, recycled water production, industrial discharge inspection and enforcement, and many other services related to wastewater. Although the WPCP has a 29.5 MGD capacity, it is currently processing about 15 MGD. One issue that will be explored in the coming year as we develop a rehabilitation and replacement plan for the plan is its optimal capacity. One alternative may be to downsize, and another may be to make some of this capacity available to other nearby jurisdictions to help defray overhead and provide additional revenue to this fund.

Infrastructure maintenance and replacement has been and remains the largest issue for the Wastewater Management Fund. Portions of the treatment plant and collection system are approaching 50 years in age and are deteriorating. For the past two years staff has worked to identify and isolate the cost and life span of the various pieces of infrastructure and schedule these into the Long Range Infrastructure Replacement plan. The recommended FY 2006/2007 Budget and Long Term Financial Plan reflects $76.3 million in infrastructure and capital projects that have been identified for the 20-year planning period through this process.

The major infrastructure and capital projects with funds programmed for FY 2006/2007 are as follows:

- **WPCP Air Conditioning Project:** This project provides $575,000 in funding for FY 2006/2007 to replace the Heating, Ventilating and Air conditioning (HVAC) systems at the Water Pollution Control Plant.

- **Rehabilitation of Digesters and Replacement of Digester Lids**: This project provides $1,610,000 in funding for FY 2006/2007, with an additional $6 million programmed from FY 2007/2008 through FY 2009/2010. Digesters at the WPCP are used to further degrade solid waste removed from the wastewater. The structural integrity of the digesters/lids must be maintained to prevent releases of potentially hazardous methane that could result in Bay Area Air Quality Management District (BAAQMD) violations. This project will provides for the design and construction of four replacement anaerobic digester covers and peripheral equipment. The results of a recent RFP for the first digester indicate that more resources may be needed to complete this project. Staff will be reevaluating the planned budget in detail during the upcoming project budget process.

- **Pond Sediment Removal:** This project provides $651,000 in funding for FY 2006/2007. The oxidation ponds provide secondary treatment using natural action of sun and wind to facilitate the growth of algae, which takes up dissolved waste from the wastewater. No solids have been removed from the ponds since the beginning of secondary treatment in the late 1960's. The current accumulation of solids is estimated at 35% to 45% of the pond volume. This project provides approximately $11.7 million over sixteen years beginning in FY 2005/2006 to remove sediment and improve pond capacity.

- **Replacement/Rehabilitation of Sewer Pipes:** The City has over 280 miles of sewer lines, in sizes from 6 inches to 36 inches in diameter. The value of these lines is estimated to be in excess of $200 million. Many of these lines are 50 years old, or older. This project includes replacement or rehabilitation of these facilities at a total cost of $18.5 million over twenty years. The project began in FY 2005/2006 and has a budget of $102,000 for FY 2006/2007.

- **Replacement/Rehabilitation of Sanitary Manholes:** The sewer system infrastructure is on average 50 years old, with some parts considerably older. The system includes over 5,700 sewer manholes. This project provides $2 million in funding over twenty years to systematically replace or rehabilitate deficient manholes. The project started in FY 2005/2006 and the proposed budget for FY 2006/2007 is $75,000.

- **Storm Pump Station # 2 Rehabilitation:** This project funds the rehabilitation of Storm Pump Station # 2, which is used to pump accumulated storm water to the San Francisco Bay. Storm pumps are required due to areas of the City that are close to sea level and therefore could suffer flooding during large storms and high tides. Storm Pump Station #2 is located at the east end of Baylands Park. The facility consists of a structure with six pumps, a pond surrounded by a levee, and an access road. The budget for FY 2006/2007 is $80,000 and the total cost over the ten year plan is $833,000.

Other major infrastructure and capital projects included in the Twenty Year Long Term Financial Plan are as follows:

- **Primary Sedimentation Basin Renovation Phase I**: WPCP primary treatment provides the removal of solids and floating material from the wastewater stream. The ten primary sedimentation basins that perform this task are old, the oldest of which were part of the original plant built in 1955. This project will provide for repair or replacement of the basins for a total project cost of $10.7 million. The work is scheduled beginning in FY 2007/2008 and ending in FY 2013/2014.

- **Air Floatation Tank Rehabilitation**: This project provides $3.2 million in funds to rehabilitate and provide corrosion protection for the four Air Floatation Tanks at the WPCP. Air floatation tanks are used to remove the algae that grow during secondary treatment in the oxidation ponds. This project includes repair/replacement of the steel and mechanical portion of this structure, repair and/or replacement of the influent gates and coating of the concrete walls, extending their useful life for approximately 20 years. This project is scheduled to begin in FY 2007/2008 and end in FY 2012/2013.

- **Fixed Growth Reactor Rehabilitation**: The fixed growth reactors at the Water Pollution Control Plant provide for the biological removal of ammonia from the wastewater stream. This project will provide funds to renovate the three fixed growth reactors. The project is scheduled to begin in FY 2014/2015 and will be completed in FY 2017/18. The total cost is budgeted at $6.9 million. The completion of this maintenance is expected to extend the life of the reactors another 20-25 years.

- **Replacement/Rehabilitation of Storm Drain Pipes:** The storm system infrastructure is, on average, 50 years old. This project replaces or rehabilitates storm water pipes at an ongoing rate of 800 linear feet per year for a total cost of $1.6 million over the second ten years of the project beginning in FY 2015/2016.

- **Sewer Lift Stations Rebuild:** The City currently operates five sewer lift stations which ensure proper flow of sewage through the sewer system. This project provides $1 million in funding to overhaul pumps and rehabilitate wet wells, traffic covers, and electrical panels. The project is scheduled for FY 2010/2011 through FY 2014/2015. The next renovation should not be necessary for at least 10 to 20 years, with an appropriate level of maintenance.

- **Storm Pump Station #1 Expansion:** Sunnyvale operated two storm pump stations to pump accumulated storm water into the San Francisco Bay. These are required for areas that are close to sea level and could suffer flooding, particularly during large storms and exceptionally high tides. The project to expand Station #1 is budgeted to start in FY 2012/2013 and end in FY 2014/2015 for a total cost of $1.9 million.

Services provided through the Engineering Division to support Wastewater capital and infrastructure projects are shown on the Project Administration line of the Long Term Financial Plan. These costs vary in relationship to the capital improvement program each year.

Projected FY 2006/2007 Operations costs for the Wastewater Management Fund decreased by 3.5% from the FY 2005/2006 Budget. This reflects actual lower costs experienced in FY 2004/2005 for WPCP chemicals and hours required for operational activities.

Environmental regulations continue to restrict numerous pollutants, requiring additional study and increased public outreach efforts to reduce the amount of pollutants reaching the San Francisco Bay. Staff is currently required to renew the City's discharge permit under these more stringent regulations. In prior years, three ongoing efforts related to our National Pollutant Discharge Elimination System (NPDES) permit and the control of non-point source discharges were shown in this fund as special projects. Since they are ongoing and are actually operational in nature, these projects were folded into operations for FY 2004/2005.

The Wastewater Management Fund has two interfund loans that were advanced from the General Fund. The first loan was to finance the remodel of the primary facilities of the wastewater treatment plant, expanding the capacity from 22.5 million gallons per day to 29.5 million gallons per day. The loan was made by the General Fund in FY 1980/1981 for a total of $10.7 million at 7% interest. The original term was for 20 years. Payment of the loan began in FY 2004/2005.

The second loan from the General Fund was made to assist the Wastewater Management Fund with cash flow issues by providing needed cash to stabilize rates. The loan was advanced in FY 1995/1996 for a total of $2.4 million at 7% interest. The term was for 20 years with ongoing payments on the loan deferred until FY 2004/2005.

The recommended FY 2006/2007 Wastewater Management Fund Long Term Financial Plan reflects changes to both loans. Payments on the first loan have been increased beginning in FY 2015/2016 and for the remaining term of the loan to accelerate the repayment to FY 2019/2020. This is six years earlier than projected in the FY 2005/2006 Financial Plan. A similar approach has been used on the second loan, with repayment accelerated to FY 2020/2021, four years earlier than projected in the FY 2005/2006 Financial Plan. These changes were made to shorten the liability to the General Fund and free up Wastewater Fund rate revenue for anticipated large infrastructure needs in the second ten years of the Financial Plan.

The Wastewater Management Fund pays debt service in the amount of $1.5 million annually for its share of the Water and Wastewater Revenue Bonds issued in 1992. These Bonds were refunded in 2001 to reduce debt service costs; at that time, additional funds of $12.5 million were borrowed to pay for needed capital and infrastructure projects. The original portion of the Bonds is repaid in FY 2018/2019 and only the new money portion continues throughout the 20-year plan.

Each year the Wastewater Management Fund makes a transfer to the General Fund as payment for the Power Generation Facility (PGF). The Power Generation Facility generates electricity for the Water Pollution Control Plant using natural gas that is a byproduct of the landfill and digester operations. The PGF replaced the need for purchasing power from PG&E to operate the WPCP. Construction of the original facility in 1997 was funded by the General Fund to the Wastewater Fund. The Wastewater Fund purchases power each year from the General Fund. The amount for FY 2006/2007 is $737,924.

One new cost was reflected in the Wastewater Management Fund Long Term Financial Plan starting in FY 2005/2006. This was charge for rent for use of the land that the Water Pollution Control Plant occupies. The WPCP resides on approximately eight acres of land. Previously, the City's General Fund received no revenue from the Wastewater Management Fund's use of this land, even though the Wastewater Fund received a benefit for its use. Taking into consideration the location and values of comparable land in the Moffett Park industrial area, discounting for the proximity to and complications associated with the Sunnyvale Landfill and Sunnyvale Materials Recovery and Transfer Station, staff recommended that the General Fund be reimbursed $12.17 per square foot for the use of the land, for a total payment of $296,748. This payment is reflected for the full term of the plan, adjusted for inflation.

The Wastewater Management Fund by policy maintains a Contingency Reserve of 25% of operations and a Rate Stabilization Reserve to levelize rates and provide for the effect of economic cycles.

The rate increase approved by Council for Wastewater services for FY 2006/2007 is 6%, one and a half percentage points lower than last year's projection. Annual rate increases for the remainder of the planning period are shown at the bottom of the Long Term Financial Plan.

Solid Waste Management Fund

The Solid Waste Management Fund accounts for the revenues and expenses related to collection, recycling, and disposal of solid waste generated within the City of Sunnyvale. A private company, Bay Counties Waste Services, doing business in Sunnyvale as Specialty Solid Waste & Recycling ("Specialty"), has been issued an exclusive franchise for collection of refuse and recyclable materials, and these contract costs are reflected here. Operations of the Sunnyvale Materials Recovery and Transfer Station and disposal of refuse at the Kirby Canyon Landfill are included in a separate fund, but the City's share of these activities is reflected in the Solid Waste Management Fund.

In budgeting for municipal solid waste management expenses, the most significant factor influencing revenues and expenses are tons of solid waste collected, transferred, and disposed. Staff begins preparation of the Solid Waste Long Term Financial Plan by projecting the amount of material that is anticipated to be delivered to the SMaRT Station.

As Council is aware, the City of Sunnyvale is party to a Memorandum of Understanding (MOU) with the cities of Palo Alto and Mountain View for the operation of the SMaRT Station. Sunnyvale and Mountain View are required to deliver all of their garbage and residential recyclables, including yard trimmings, to SMaRT. Palo Alto continues to operate its own landfill, and facilities for yard trimmings and compost and recycling, and therefore that City is required to deliver only specific amounts of garbage that vary from year to year.

In projecting the tons to be brought to the SMaRT Station, staff first sets a base tonnage and then works with the other two cities to project tonnage through the first ten years of the plan. Current tonnage trends at SMaRT indicate that FY 2004/2005 was the low point in the economic downturn as tons of solid waste disposed are an indicator of construction and redevelopment activity. The most recent twelve month period available shows an upward trend in tons delivered by all three cities and the public to the SMaRT Station. Revised Sunnyvale tonnage projections for FY 2006/2007 are up 1% from the tons now expected for FY 2005/2006. Year to year decreases and increases in garbage tonnage are difficult to project accurately, so the financial plan smoothes future trends into a 1% per year increase throughout to provide a more reliable long-term projection.

As mentioned earlier, the City contracts with Specialty for the collection of solid waste and recyclables throughout the City. Specialty is paid on a monthly basis, but their payment is determined for a year based largely on formulas that take necessary and actual expenses in the last completed fiscal year and adjust them for information. Therefore, the contractor payment for the following fiscal year is driven primarily by actual expenditures from the prior year that are adjusted by various indexes as identified in the contract.

The projected FY 2006/2007 contractor payment is up $294,214, or 1.9%, from the costs for FY 2005/2006, primarily due to higher than anticipated increases in fuel costs.

One new cost that was reflected in the Solid Waste Fund Long Term Financial Plan starting in FY 2004/2005 was a charge for rent for use of the land that the SMaRT Station occupies. The SMaRT Station is located on a parcel of land also occupied by the landfill that records indicate was originally purchased by the City with the intent of establishing a park. The facility resides on 9.5 acres of land. Previously the City's General Fund received no revenue from the Solid Waste Management Fund's use of this land, even though the Solid Waste Fund receives a benefit for its use. Taking into consideration the location and values of comparable land, a new charge was levied to reimburse the General Fund $11.25 per square foot for the use of the land. This payment is reflected for the full term of the plan, adjusted for inflation.

The Solid Waste Management Fund Long Term Financial Plan reflects two interfund loans that were advanced from the General Fund. The first loan provided $3.68 million during 1985, 1988, and 1989 to construct a system to convert methane gas to a marketable form of energy. An additional $10.5 million was advanced for the purpose of stabilizing solid waste rates between FY 1994/1995 and FY 1998/1999. Both loans bear interest of 7%. The loans have since been combined and their original terms were to have them paid off over 29 years. Initial repayment began FY 2004/2005, was deferred for one year in FY 2005/2006, and continues through FY 2023/2024.

The FY 2006/2007 Solid Waste Management Fund Long Term Financial Plan reflects a change to the loan schedule. Beginning in FY 2014/2015 payments are increased for the remainder of the term. This accelerates the repayment of the loan to FY 2019/2010, five years earlier than projected last year.

By fiscal policy, the Solid Waste Fund maintains a Contingency Reserve of 10% of operations. This is less than the 25% required for the other two utility enterprises to reflect that fact that this operation has less risk for damage or disaster. The Fund also maintains a Rate Stabilization Reserve similar to the other utilities.

The rate increase adopted by Council for FY 2006/2007 is 5.5%, the same as planned last year. The projected rate increases for the remainder of the planning period are reflected at the bottom of the Solid Waste Management Fund Long Term Financial Plan. It should be noted that costs over the first ten years of the plan have risen by about 40%, due to increases in collection (the Specialty Contract) and disposal (SMaRT and Kirby Canyon landfill.) Changes in costs at SMaRT will be discussed in more detail below.

Sunnyvale Materials Recovery and Transfer (SMaRT) Station

The Sunnyvale Materials Recovery and Transfer Station Fund consists of two sub-funds. The SMaRT Station Fund accounts for operations at the SMaRT Station and receives its revenue from charges to the cities of Sunnyvale (Solid Waste Management Fund), Mountain View, and Palo Alto. Major operating cost components include the contract with Green Team/Zanker, the SMaRT Station operator, and disposal fees and taxes collected by the Kirby Canyon Landfill. The fund is designed so that annual revenues and expenditures are in balance and that no fund balance is carried forward to the next year. Operating costs and revenues from the sale of recyclables are charged to or distributed to the cities based on the numbers of tons of solid waste each community brings to the SMaRT Station for materials recovery, transfer, and disposal.

Prior year projections of tons to be brought to the SMaRT Station by each city had Palo Alto deliveries of garbage more than doubling beginning in 2011. All of Palo Alto's yard trimmings, currently composted at their own landfill, were also projected to begin coming to SMaRT as Palo Alto anticipated closing its landfill. The effect of this projection was to increase Palo Alto's share of SMaRT operations and lower those of Sunnyvale and Mountain View.

This year's projections from Palo Alto have changed significantly. In the past year, Palo Alto adopted a "Zero Waste" policy that set a goal of ultimately diverting 90% of that City's waste. Details of the methods that Palo Alto will use to achieve its ambitious goal are still being developed, but Palo Alto staff has reduced the SMaRT Station projection for the amount of municipal solid waste to be delivered in future years. The net effect of this change is to increase the projected expenses shares of Sunnyvale and Mountain View for FY 2011/2012 and beyond compared to last year's Financial Plan.

The SMaRT Station Replacement Sub-fund provides for the replacement of City-owned SMaRT Station equipment. The three participating cities contribute to these replacement efforts and to payment of debt service based on fixed percentages established by the SMaRT Station Memorandum of Understanding (MOU) among the cities.

For FY 2006/2007, the SMaRT Station Fund reflects the impacts of a project to replace the two materials recovery lines at the SMaRT Station. The project will meet the following goals:

- Update the facility with current materials recovery technology
- Reduce the amount of equipment downtime and repair
- Increase the diversion of recyclables from the waste stream
- Increase the revenues from the sale of recyclables
- Reduce landfill disposal costs
- Reduce operating (labor) costs

The project budget is $5 million, shared by the three partner cities. On completion, the project is expected to reduce ongoing costs and increase revenues so as to provide a net present gain of approximately $11 million through the end of the MOU term in 2021. The specific financial effects of the project are reflected in the various revenue and expense components of the Financial Plan.

The recommended FY 2006/2007 SMaRT Station Long Term Financial Plan reflects debt service for the original cost of the facility through FY 2017/2018. Staff projects that while most of the equipment can be maintained in good working order through the term of the MOU, there will come a point when major equipment and the structure itself will need replacement. In order to allow for the cost impact of this eventuality, staff has projected the debt service to continue at the existing level beyond the term of the MOU.

One issue that may have a significant fiscal impact on the SMaRT Station is the current status of the contract between the City and Green Team/Zanker, which expires at the end of 2007. A Request for proposals process is currently underway. Periodic bidding provides the benefits of the competitive market with minimal risk and also allows the scope of work and other contract terms to be updated to reflect updated policy direction, changes in law, and lessons learned. The contract is currently scheduled to be awarded in February 2007, with the new contract taking effect on January 1, 2008. The FY 2006/2007 Long Term Financial Plan does not assume any savings from the bidding of the SMaRT Station contract. However, it is anticipated that the City will likely receive more favorable pricing through the bidding process.

Community Recreation Fund

The Community Recreation Fund, which was created in FY 1991/1992, contains the recreation activities of the City, including the two City-operated golf courses, the tennis center, and recreation classes and services. Prior to the initiation of the Fund, recreation services were part of the General Fund. The creation of the Community Recreation Fund included the merger of the City's golf and Tennis Center operations with the remainder of all other recreation service activities, as well as the adoption of new, entrepreneurial approaches to service delivery. This approach resulted in a significant reduction in the General Fund subsidy that would have been required to support recreation services in future years.

Several changes are proposed in FY 2006/2007 to better define and allow more control over the services and activities that are provided through the Community Recreation Fund, independent of those provided by the General Fund. These changes will realign the services and activities with the most appropriate fund (the Community Recreation Fund or the General Fund) that supports those services.

For example, total operational and maintenance costs for the parks, athletic fields, and picnic areas are the responsibility of both the Parks Program and the Arts and Recreation Program. In order to provide more visibility to the actual impact to the Community Recreation Fund for the costs attributable to the Arts and Recreation Program activities, adjustments to how revenue is received in the Community Recreation Fund will be changed for certain activities. For rentals of park buildings, picnic areas, and athletic fields, the revenue received will be applied to the General

Fund. The expense attributed to the Community Recreation Fund for each of these activities will then be reimbursed from the General Fund and will be considered a revenue for the Community Recreation Fund. The difference between the total revenue received for each activity and the corresponding expense reimbursed to the Community Recreation Fund, if positive, will be added to the total General Fund subsidy to the Community Recreation Fund.

There is no net impact to the Community Recreation Fund or the General Fund for accounting for the revenues in this way in comparison to the methodology used in FY 2005/2006, when all revenues for these activities went directly into the Community Recreation Fund. A similar methodology has been applied to the Baylands vehicle entry and reservation revenues and expenses as well, with the intention of maintaining the overall revenue to the Community Recreation Fund while providing better visibility of the cost to the Fund for providing these services.

Other similar changes were made for FY 2006/2007, including:

- $125,538 in revenues from the lease of four artist studios and Raynor Day Care Center space at the Raynor Activity Center will be transferred to the General Fund because the expenses of operating the Center are there. This same amount will be added to the General Fund subsidy to the Community Recreation fund to ensure zero net impact.
- $21,046 in expenses for Youth Employment Services, a program administered by NOVA, will be transferred to the General Fund and the subsidy will be reduced.
- $46,388 in expenses for Proven People, an employment program for Sunnyvale seniors – will be transferred from the General Fund into the Community Recreation Fund and this program will be provided under contract between the Departments of Parks and Recreation and Employment Development. To cover the additional expense for this program, the General Fund subsidy will be increased by the budgeted expense of the Proven People Program to ensure no net impact to the Community Recreation Fund.
- Revenues and expenses for certain activities related to the Columbia Neighborhood Center will be moved into the Community Recreation Fund. To the extent that expenses exceed revenues for these activities, the difference will be added to the subsidy from the General Fund.
- $72,000 of cell phone tower rental revenue from towers located in City parks that will be deposited in the General Fund will be added to the subsidy from the General Fund to the Community Recreation Fund.
- $12,298 is planned in FY 2006/2007 from the General Fund for the Euphrat Museum's After School Art Program. However, based on recent revisions in the Council's Human Services policy and Outside Group Funding process, in order for funds for this program to continue past June 2007 it must be considered in the context of all other recreational services and included in the City Manager's budget request for future years. It will be proposed as a budget supplement for funding in FY 2007/2008.

The recommended FY 2006/2007 Budget includes this realignment, which will provide a much clearer picture of the real subsidy from the General Fund for recreation programs. The realignment also provides the incentive to Parks and Recreation staff to be as efficient as possible, since the subsidy will be held to a fixed amount plus inflation. In future years, the Fund will need to cover all cost increases related to operating this enterprise. The only exception is for those new services, including those provided to other organizations as approved by Council, which will receive funding through a corresponding increase in the General Fund subsidy. The Fund will be allowed to retain any fund balance generated from cost savings, revenue initiatives, etc. to assist in keeping service levels stable during slower economic periods.

The recommended FY 2006/2007 Budget for the Community Recreation Fund includes a number of key issues for Council consideration, as discussed below.

Structural Imbalance

The Adopted FY 2005/2006 Budget recognized that the Community Recreation Fund had a structural imbalance between revenues and expenditures starting in FY 2006/2007. This imbalance was shown on the Long Term Financial Plan as a "*Fiscal Strategies*" expenditure line item in the amount of $650,000 gradually increasing over the full twenty years. This line item reflects the amount that the Community Recreation Fund would have to decrease its expenses (or increase its revenues) starting in FY 2006/2007 in order to continue to be in balance and not draw further on the General Fund.

During FY 2005/2006 Parks and Recreation staff developed a series of recommendations for service level reductions or increased revenues to help reduce the structural imbalance. A preliminary plan representing a total of $413,000 was presented to Council at the Fiscal Issues Workshop in January 2006 and received preliminary Council approval. Details of the plan are included in the *Budget Supplements* section of the Budget Workshop as Budget Supplement # 12. The proposed service level changes and revenue enhancements have been reflected throughout the recommended budget for the Community Recreation Fund.

General Fund Subsidy

The recommended FY 2006/2007 Budget provides almost $12 million worth of diverse recreation programs and services to the community with a total subsidy from the General Fund of $3.9 million. Approximately $1 million of this subsidy is returned to the General Fund to cover administrative in-lieu costs, making the net subsidy $2.9 million. The remaining cost of recreation programming will be paid primarily by the direct beneficiaries of the programs in the form of user fees.

When the Community Recreation Fund was established in FY 1991/1992 the General Fund subsidy was approximately $2 million, with $91,000 returned to the General Fund for in-lieu charges. When converted to today's dollars, the same level of subsidy would be approximately $3 million, and the in-lieu charges would be $142,000, for a net subsidy of $2.9 million. As this information indicates, over the intervening years the subsidy has held constant in spite of the fact that the service level approved by the Council has increased. In many cases, the required increase in expenditures has occurred with no corresponding increase in General Fund subsidy.

Examples of some of the significant increases or factors influencing the fund over the past six years are noted below:

Summary of Significant Actions Impacting
Community Recreation Fund

Service or Program Description	Increase Amount
1999/2000	
New and expanded teen programs	$237,890
Subsidy increase in fee waivers	$15,000
2002/2003	
Net operating costs budgeted for Fremont High School pool	$134,378
Net increase in costs from Recreation Division reorganization and transition of temporary positions to City staff.	$89,768
2003/2004	
"Fun on the Run" transferred to Recreation Division	$74,120
Final cost increase to transition temporary positions to City staff	$57,500
Budget Modification approved for Senior Lunch program	$80,000
Budget Modification approved to continue Fee Waiver program (transferred from Swirsky Trust Fund)	$10,000-$12,000
Budget Modification approved to temporarily waive Park Building use fees for non-profit groups.	$26,791
2005/2006	
Pool and golf equipment replacement project costs moved from Capital projects into Recreation operating budget	$24,300
Budget Modification approved to continue Senior Lunch Program while RFP process was underway	$25,000
Rental Rates to IT Dept. increased to support registration and reservation software	$13,000
Budget Modification approved to continue Fee Waiver program through September.	$76,000
Payment to Sunnyvale Community Services to administer Recreation Fee Waiver program	$10,000
Reserves from Community Recreation Fund used to support Senior Lunch Program	$24,000

As mentioned above, it is recommended that the subsidy amount resulting from the realignment of revenues and services be fixed at the FY 2006/2007 level and grow by inflation over the Long Term Financial Plan. Any increase in service levels that is not covered by revenues would then require the Council to approve an additional subsidy from the General Fund.

Consideration of Family Day

In June 2005, Council considered RTC 05-164: Explore Costs and Benefits of Declaring the Second Saturday in August as "Family Day" and Open Recreation Facilities to the Entire Community. Budget Supplement No. 12 further explores this concept in accordance with Council direction, concluding that if Council approves and implements Family Day, there will be an added cost to the Community Recreation Fund of approximately $8,000 - $12,000. If these costs are not offset by a transfer from the General Fund, they must be absorbed within the Community Recreation Fund. In that event, other subsidized recreation programs would need to be reduced or eliminated. This recognizes the structure imbalance within the Fund as described above.

Golf Services

Golf operations continue to be the greatest single source of revenue for this Fund, providing over $1.2 million of direct net profit to the Fund in FY 2004/2005 to support other subsidized recreation services. This reflects a 25% decrease from FY2003/2004 when $1.6 million in net profit was realized from the golf courses. Golf play on a nationwide level continues to decline since reaching a peak in 2000/2001. Industry estimates indicate rounds of golf at public access facilities are down 2-3% from the previous year. Informal surveys of area courses reflect a reduction in play of 15-25% from peak highs in 2000/2001 while golf round totals from Sunnyvale courses over this period are down a combined 16%.

However, Sunnyvale golf play statistics through the first six periods of this fiscal year, along with current information collected from regional golf facility operators, presents some better news. Despite the high number of rainy days in spring 2006 staff is hopeful that an improvement in golf play is imminent. The most recent trend analysis suggests that Sunnyvale golf courses (and other courses in the area) have reached a bottom in declining participation. While the Long Term Financial Plan estimates for golf play and associated revenues have been pushed lower each of the previous four years the estimate for FY 2006/2007 through FY 2015/2016 reverses this trend. While not projecting an immediate return to peak levels, future years' estimates provide a modest and continued improvement. This improvement should be noticed at Sunnyvale Golf Course first, primarily due to the number of companies relocating near the course, followed by Sunken Gardens which is more influenced by overall economic conditions, one to two years later.

The most significant conditions that may provide positive impacts to golf play are:

- Noticeable improvement in local economic conditions.
- Occupancy rate of near-course commercial buildings has steadily improved, with a number of recent, high profile, companies relocating near the Sunnyvale Golf Course.

- Continued high overall customer satisfaction with golf course conditions and level of service. Annual surveys indicate that current customers are extremely pleased with their golf experience in Sunnyvale.

There are continuing challenges ahead as more golf courses have been added in the area along with high-end courses that continue to compete for Sunnyvale customers. Golfers are becoming more discerning and demanding, looking for the best value for their dollar. Many will prefer a more “full service” facility than the amenities offered at Sunnyvale’s courses. As a result, the golf operations is one of the initiatives staff will be analyzing in the next year to take a fresh look as to where Sunnyvale needs to go

Council's continued support of market-based golf fees regardless of residency or age (with the exception of monthly discounts for residents, seniors, youth and disabled golfers) remains a critical factor in maintaining this important revenue stream. The proposed FY 2006/2007 budget reflects a $2 increase in weekend green fees and a $1.50 increase in weekend twilight fees for Sunnyvale Municipal starting in April 2007. However any increases in fees beyond inflation are not shown in the proposed fund balance beyond FY 2010/2011.

Senior Lunch Program

In September 2005 City Council approved an agreement with Culinary Magic Catering to provide a service level up to 21,000 meals, based on a maximum of 84 meals and a minimum of 25 meals per day to be prepared at the Sunnyvale Senior Center for the Senior Lunch program. In addition, reserve funds in the Community Recreation Fund were used in order to absorb the increased cost of the Senior Lunch program. This increase included a temporary subsidy of the program to allow the first 1,000 meals to be provided at a cost 50 cents less than the planned cost of $4.50 until the end of December 2005, to allow the new caterer to get a head start. For FY 2006/2007, the Senior Lunch program will continue to cost approximately $24,000 more than the estimated revenue. Although participation has increased from an average of 27 persons per day in the fall of 2005 to an average of 40 per day in the first half of 2006, it is still short of the goal of 84 meals served per day. Future fee increases for the Senior Lunch program will be evaluated on an annual basis within the context of all the other recreation program and service fees.

One issue of concern for the future of the program is the fact that the caterer is currently reliant upon special events in addition to the core Senior Lunch program in order to make a profit. This issue will need to be monitored carefully over the next year.

Fee Waiver Program

The fee waiver program is an important component of the City's delivery of recreation services. It allows the economically disadvantaged to participate in programs by defraying the established user fees. As it did in FY 2004/2005, the program experienced increased participant use of fee waivers well beyond planned amounts and resulted in the need for Council action to avoid spending beyond approved budgets. In February 2006 Council authorized a $76,000 Budget Modification to continue the program for economically challenged residents through the end of the fiscal year. The Budget Modification requires eligible participants to pay a minimum of $1.00 to the Senior Lunch Program (per person per meal), reduced the maximum amount of fee waiver allowed per individual from $250 to $180, and limited income criteria to “very low” and “very very low” categories. It also added $57,000 to the budget amount limit to continue it into September 2006 when a Study Issue covering this topic will be presented to Council. The Study Issue will explore changes in eligibility for fee waivers as well as possible limitations on the types of programs to which fee waivers apply.

Swirsky Youth Opportunity Fund Transfer

In April 2005 Council approved the continuing use of two-thirds of the interest earnings of the Swirsky Youth Opportunity Fund by the Community Recreation Fund as recommended annually by the City Manager. In FY 2005/2006 the interest was used to supplement the Mobile Recreation Program. The remaining one-third of the interest was given to Sunnyvale Community Services per Council direction to purchase recreational equipment and supplies for disadvantaged youth living in Sunnyvale. For FY 2006/2007 the City Manager is recommending that all of the interest be used to supplement the Mobile Recreation Program and the City’s agreement with Sunnyvale Community Services will be revised to reflect this change.

Infrastructure Projects

The City maintains and funds a planning system for repair and replacement of significant pieces of City infrastructure. To mention a few, items include roofs and heating/air conditioning systems, pool renovations and recreational equipment. Those projects and items specific exclusively to the Community Recreation Fund have been listed in the *Current Requirements* section of the Long Term Financial Plan. In general, these have been limited to Golf Course and Tennis Center improvements, with parks related infrastructure funded by the General Fund. Over the last ten years, approximately $1.6 million in capital projects have been completed, and projected future costs through FY 2015/2016 are $2.7 million. These project costs are accounted for in the Infrastructure Renovation and Replacement Fund/Community Recreation Sub-Fund.

As a part of the Capital Projects focus last year, staff has reviewed funding sources for these infrastructure projects and has determined that infrastructure projects and equipment on park lands can and should be funded through the Park Dedication Fund. Therefore, future costs for infrastructure projects and equipment, including Golf and Tennis, are no longer noted in the Community Recreation Fund.

Future Fiscal Condition

The recommended FY 2006/2007 Budget and Long Term Financial Plan includes no new capital projects in the Community Recreation Fund. Two small special projects are included: $1,000 for Cooperative Middle School activities and $18,359 for a Business Plan for the Community Center Theatre.

The Fund contains two reserves. The first, *Co-op Sports Reserve*, reflects requirements of a contract that the City has with the Sunnyvale School District to administer the after school intra-mural sport league programs at Sunnyvale Middle School and Columbia Middle School. The reserve carries over funds for the Sunnyvale Middle School program, which generally brings in more revenue from participant fees than is needed to cover direct program costs. The reserve funds are used to purchase equipment and uniforms as needed by the school.

The second reserve is the *20-year Resource Allocation Plan (RAP) Reserve*, which functions here as in other funds, to levelize expenses and revenues over the planning period. As stated earlier, we expect the 20-Year RAP Reserve to end FY 2005/2006 with $1.2 million that will be drawn down to maintain existing service levels in FY 2006/2007 and beyond. The 20-Year RAP Reserve gradually diminishes to about $251,000 in FY 2010/2011 and then builds up to a modest level throughout the Plan. The Fund will be allowed to keep any revenues above projections and savings from service level efficiencies in a given year to help stabilize economic cycles and maintain service levels.

SPECIAL REVENUE FUNDS

Special Revenue Funds are used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for specified purposes.

Housing Fund

The Housing Fund is comprised primarily of revenues from federal HOME grants, housing mitigation funds, and Below-Market-Rate ("BMR") receipts. Expenditures are for operating activities related to developing affordable housing and managing the City's below-market-rate housing program and for capital and special projects targeted to achieve the goals of the City's Housing and Community Revitalization Sub-Element of the General Plan and the 2005-2010 Consolidated Plan. The Consolidated Plan is a five-year comprehensive planning document submitted to the federal government. It identifies a jurisdiction's overall needs for affordable housing and non-housing community development. The federal government requires the City to submit annual updates during the intervening years of the Consolidated Plan, and this is generally done in May of each year.

Housing Mitigation Sub-Fund

Housing Mitigation fees are paid by high-intensity industrial developers to mitigate development impacts on the City's jobs/housing balance. These funds are used to support the provision of affordable housing within the City. Housing mitigation funds, including accrued interest, are maintained in a separate sub-fund of the Housing Fund.

During the first ten years of the Long Term Financial Plan, Housing Mitigation fees in the amount of $3.7 million are projected to be received from known developments through FY 2013/2014. Development plans currently under consideration for the Moffett Park area may yield additional fee revenues in the future. However, these revenues have not been included in the projections pending finalization of the plans.

Housing Loan Repayment revenues for FY 2006/2007 reflect payment, with interest, on a bridge loan made to Emergency Housing Consortium in 2002. $350,000 of the loan came due in 2004 and is past due. The amounts programmed in FY 2006/2007 through FY 2015/2016 reflect a new annual repayment plan for the portion of the loan that is due. The remainder of the bridge loan is deferred for 30 years. Additional Housing Loan Repayment revenues beginning in FY 2009/2010 reflect an estimate of funds owed under the Housing for City/Public School/Child Care employees program.

Real property sales of $674,000 are programmed for FY 2009/2010 to reflect the sale of the property located at 388 Charles Street in downtown Sunnyvale. This property was scheduled to be purchased by the Housing Mitigation sub-fund during FY 2005/2006 for rental to low and moderate income families. The sale is expected to be complete before the end of this fiscal year. In keeping with the policy adopted by Council last year, this property and the others owned by the General Fund in downtown will be sold following development of the Sunnyvale Town Center. Rental income from the property until the sale is reflected on the Long Term Financial Plan through FY 2008/2009.

Interest income on the reserve balances in this sub-fund continues to accrue and is available for programming of future housing mitigation projects.

The primary project expenditures for the Housing Mitigation Sub-fund in FY 2006/2007 and beyond are for the Housing Assistance for Teachers and City Employees special project. This program, which began in FY 2001/2002, consists of three components: Homebuyer Education, Security Deposit Loan Program and Down Payment Assistance Program. The current budget for FY 2005/2006 is $1.2 million. An additional $200,000 is programmed annually starting in FY 2006/2007 and continuing throughout the twenty-year plan. The Sub-fund also includes a small special project for maintenance of the Charles Street affordable housing unit until its sale in FY 2009/2010.

In FY 2005/2006 Council contributed an additional $300,000 in Housing Mitigation funds to the Housing Trust Fund of Santa Clara County. With the support of corporate and community investors, the Housing Trust Fund serves as a catalyst to develop affordable housing in Santa Clara County through loans and grants to qualified first-time homebuyers and to developers of affordable multifamily and special-needs rental housing and housing for the homeless. The goal of the Housing Trust Fund is to help a minimum of 1,000 families per year for the next three years. The City's contribution is targeted toward housing development in Sunnyvale. Per Council direction, an additional $300,000 donation from the Housing Mitigation sub-fund is programmed for the Housing Trust Fund in FY 2007/2008.

By the end of FY 2006/2007 the Housing Mitigation sub-fund is projected to have a Housing Mitigation Reserve balance of approximately $6.9 million. These funds are available to be loaned to non-profit agencies for affordable housing projects in the City as they are identified.

HOME Sub-Fund

HOME funds are also maintained in a separate sub-fund of the Housing Fund. In general, HOME grants from the federal government may be used to fund provision of affordable housing units. Eligible activities for HOME grant funds include: acquisition, new construction, rehabilitation and down payment assistance. The activities must benefit low and moderate income households, at or below 80% of area median income.

The City has been notified that its allocation of HOME monies for FY 2006/2007 totals $703,400. These funds are being recommended in FY 2006/2007 for Operations ($70,165), and one special project. This project provides a total of $1.3 million in HOME funds from the FY 2006/2006 allocation and prior year unspent funds for the acquisition and new construction by non-profit housing development organizations. As specific projects are identified, they will be brought to Council for approval.

Below Market Rate (BMR) Housing Sub-Fund

Finally, the Housing Fund has a third sub-fund that contains Below-Market-Rate and other grant-supported housing activities. Revenues in this sub-fund include BMR processing fees, housing loan repayments, revenues from BMR code violations, and interest earnings. Expenditures are operating costs associated with maintenance and monitoring of the BMR program ($324,003) and two special projects ($592,647). One on-going special project in this sub-fund provides for the auditing of BMR participants to ensure compliance with program regulations. The second special project provides $541,000 each year through FY 2007/2008 for First-Time Homebuyer Support.

The Other Grant Supported Housing Sub-fund maintains three reserves. The first is the BMR In-Lieu Reserve which is to be used for BMR related activities. The second is the 20-year Resource Allocation Plan Reserve which is used here as in other funds to levelize spending or provide funds for capital expenditures. Finally, a third reserve accounts for Low and Moderate Income Housing Funds that are expected to be available from the Redevelopment Agency beginning in FY 2016/2017 for housing development.

Community Development Block Grant (CDBG) Fund

The Community Development Block Grant Fund consists of two sub-funds which account for revenues from Community Development Block Grants and the repayment of commercial and residential loans. Primary expenditures are for operations, housing opportunities, special projects, and most of the City's outside group funding efforts.

Community Development Block Grant Sub-Fund

This sub-fund accounts for Community Development Block Grants from the federal government. The Federal Government has notified the City that its FY 2006/2007 entitlement will be $1,271,752, which is 10.4% lower than the FY 2005/2006 allocation. Similar to the long-standing strategy used with all federally financed programs, future grant receipts are not shown beyond the fiscal year in which the entitlement amount is known.

Traditionally, CDBG funds are used primarily to address the City's affordable housing strategy. This includes support of housing agencies; rehabilitation and retrofitting of the existing housing stock; and the acquisition, rehabilitation, and construction of affordable housing by non-profit developers. As in the Housing Fund, capital and special projects are targeted to achieve the goals of the City’s Housing and Community Revitalization Sub-Element of the General Plan and the 2005-2010 Consolidated Plan. Additionally, by regulation, up to 15% of the annual CDBG allocation plus prior year program income may be used for human services and public services programs. CDBG funds may also be used for projects that benefit groups with special needs such as senior and handicapped citizens or for targeted geographical areas that meet certain income requirements.

Expenditures programmed in FY 2006/2007 for the CDBG Sub-fund include $540,405 for operations and a transfer of $6,295 to the Housing Mitigation sub-fund for purchase of a loan portfolio tracking system.

The recommended FY 2006/2007 Budget includes $271,600 for Outside Group Funding of seventeen local agencies. Special projects are proposed in the amount of $230,000 for activities that include: the Home Access, Paint and Emergency Repair Program (($100,000), Fair Housing Services ($30,000), and the City's ADA Curb Retrofit project ($100,000).

One capital project is proposed for FY 2006/2007 utilizing CDBG funds. This project, in the amount of $492,163, supports the preparation of an application that will be submitted to the U.S. Department of Housing and Urban Development requesting Section 108 loans to facilitate the expansion of the Columbia Neighborhood Center and support projects that benefit neighborhood and economic development activities in targeted locations.

Details of the Special and Capital projects are included in *Volume II, Projects Budget.*

<u>CDBG Revolving Loan Sub-Fund</u>

The Revolving Loan Sub-fund was established by Council action in 2001 and separated for accounting purposes in FY 2003/2004. This revolving fund was created to provide a practical budgetary management tool to deal with program income from housing loans made with CDBG funds and to provide greater flexibility in the management of the City's housing assistance programs.

The Revolving Loan Sub-fund has one source of revenue, housing loan repayments. This revenue consists of payouts of deferred loans and regularly scheduled monthly payments. These repayments are expected to total $609,386 in FY 2006/2007. The loan repayment projected out over the 20-year plan reflects staff's estimate of deferred and regularly scheduled payments based on the City's loan portfolio.

The recommended FY 2006/2007 Budget contains two special projects for the Revolving Loan Sub-fund. The first is Housing Rehabilitation Loans which are provided to existing rental properties that serve low-income households. Funds are budgeted in a total amount of $1.2 million next fiscal year to provide approximately 20 loans in amounts varying from $20,000 to $60,000 and $700,000 for rehabilitation of multi-unit properties. This project continues each year throughout the financial plan in varying amounts.

The second special project is for Housing Acquisition projects by non-profit developers to maintain the City's stock of affordable housing units. $500,000 has been budgeted one-time in FY 2006/2007 with no ongoing appropriations. However, the 20-Year Resource Allocation Plan Reserve is projected to increase substantially as loans are repaid and staff anticipates that these funds will be used as high-priority projects become available.

Park Dedication Fund

The Park Dedication Fund was established to meet statutory requirements regarding the accounting for park dedication monies. In general, the City collects park in-lieu fees for multi-family residential projects that do not dedicate land for use as parks or open space. This fee is now calculated on an average fair market value per square foot as determined by the Community Development Department annually. These revenues are recognized in the Park Dedication Fund, and then available resources are appropriated here or transferred to the Capital Projects Funds for designated and approved park-related projects. Revenues in this Fund also include rental income from certain houses that the City purchased with Park Dedication Funds in anticipation of park expansion projects.

It is estimated that approximately $1.8 million in Park Dedication Fees will have been received during FY 2005/2006. Staff from the Community Development Department project that residential development subject to the Park Dedication Fee will be high for an additional four years, FY 2006/2007 through FY 2009/2010 and that over $11 million in fees will be received over that time period. It should be noted an increase in the Park Dedication Fee to $81 per square foot is proposed for FY 2006/2007.

Residential construction subject to Park Dedication Fees is projected to cease in FY 2010/2011 through FY 2012/2013 in keeping with the construction development cycle that the City has utilized to forecast its building related revenues. The cycle is expected to peak again in FY 2013/2014 and in FY 2020/2021, with revenues being forecast at a much reduced level.

The Park Dedication Fund also receives rental income from six houses that the City purchased in anticipation of expanding Murphy Park and Orchard Gardens Park. Staff is recommending that these two parks be kept in their current configurations as neighborhood parks. Instead, the houses would be sold to fund construction of a Citywide sports complex or other citywide park facility. The Long Term Financial Plan projects that the rental revenue will end in FY 2016/2017 when the houses are sold. At that time, the Fund will realize land sale proceeds of $5 million which will be available to help finance the sports complex. Following the overall review of our parks system that is proposed for FY 2006/2007 (see *Initiatives* section of this Transmittal Letter), a capital project will be developed for the sports complex as appropriate.

The Park Dedication Fund receives interest earnings on its unexpended fund balance. For FY 2006/2007 this is estimated to be about $275,000.

To date, the largest single appropriation of Park Dedication Funds has been for the design and construction of the Plaza del Sol. A total of $4,424,405 was spent in support of that project from these fees. Park Dedication Funds have also been used for the Fair Oaks Skateboard Park and Playground Improvements at Ortega Park. Park Dedication Funds have also been appropriated to the Historical Society Museum Project in the amount of $500,000.

Recognizing the financial difficulty being experienced by the General Fund over the next several years, the FY 2005/2006 Budget adopted a new fiscal strategy for the Park Dedication Fund. This strategy transfers the total responsibility for the City's Parks-related capital and infrastructure projects to the Park Dedication Fund, thereby relieving the General Fund of these costs. A total of $21.4 million in transfers to the Community Recreation, Capital Projects and Infrastructure Rehabilitation and Replacement funds are programmed throughout the Long Term Financial Plan.

For FY 2006/2007 it is recommended that one major capital project be funded from Park Dedication Funds. Fund in the amount of $203,980 are programmed for design of the Plaza del Sol Phase II including a memorial, with $2.025 million programmed for construction in FY 2007/2008. In accordance with recent Council direction, the project now includes $28,980 for a memorial dedicated to Sunnyvale residents and employees who have given their lives in service of the City and country. FY 2006/2007 also includes $1.02 million for the Park Land Acquisition project.

Details of the special and capital projects are included in *Volume III, Projects Budget*.

Asset Forfeiture Fund

The Asset Forfeiture Fund was established to account for monies received through drug and other law enforcement activities as allowed under Federal and State asset forfeiture guidelines. The purposes for which asset forfeiture can be used are limited, and funds are drawn down for new one-time expenses targeted for law enforcement services. As this is done, caution should be used to assure that these expenses are ones that fit into the City's priorities and that don't lead to unnecessary future liabilities.

It is expected that the Asset Forfeiture Fund will end FY 2005/2006 with about $1.3 million in reserves and it is not anticipated that any further funds will be received over the Long Term Financial Plan. The Fund does earn interest revenue on its unexpended balance. For FY 2006/2007 this is projected to be about $54,000.

The recommended FY 2006/2007 Budget includes one small operating expense in this Fund to cover allowable ongoing costs related to the yearly asset forfeiture audit. In addition, it includes a continuing transfer to the General Fund to support juvenile diversion activities within Police Services. The City currently has an agreement with the County of Santa Clara to pay for the direct salary, not including benefits, of one Deputy Probation Officer. For FY 2006/2007 this amount is $87,803.

The recommended FY 2006/2007 Budget includes $82,000 for three capital projects to be funded from the Asset Forfeiture Fund. These include: $48,000 for the Public Safety Nextel Cellular phone system, $24,000 for the replacement of night vision surveillance equipment, and $10,000 for the replacement of SWAT team equipment. Starting in FY 2007/2008 the ongoing capital project is funding for the cellular phone system costs.

Assuming that no new asset forfeiture monies will be received in the future, the Asset Forfeiture Fund is projected to be depleted by FY 2015/2016.

Police Services Augmentation Fund

The Police Services Augmentation Fund accounts for two grant programs that provide monies for law enforcement purposes. The first is the Supplemental Law Enforcement Services ("SLES") program established by the State, and the second is a small Federal Local Law Enforcement Block Grant (LLEBG) from the Bureau of Justice Administration ("BJA").

The State SLES monies constitute the major portion of this Fund. The City first received the SLES grant in FY 1996/1997. Over the years, the amounts of both grants have decreased significantly. SLES has reduced over 35% from a high of $297,886 to the current $192,027. BJA has decreased from a high of $70,158 to the current $10,807.

As of FY 2005/2006 the Bureau of Justice Administration replaced the LLEBG program with a different funding mechanism called a Justice Assistance Grant (JAG). This program is intended to simplify the administration process for grantees and now requires no General Fund match.

Initially the Police Service Augmentation Fund monies were used to fund a full-time Domestic Violence Investigator, a Patrol Watch Commander, and participation in the State Bureau of Narcotic Enforcement's Bay Area Regional Narcotics Task Force. Beginning in FY 1999/2000 Council approved use of the SLES and BJA revenue to fund the Patrol Watch Commander and two Internal Affairs Investigators. Due to the continual decline of funding and increased personnel costs, by FY 2003/2004 the grants were no longer able to support the three positions and funds were allocated to support a Patrol Watch Command position and a portion of an Internal Affairs Investigator. The adopted FY 2004/2005 Budget supported only a Patrol Watch Command position with SLES/BJA funds. The Internal Affairs Investigator hours were moved to the General Fund operations of the Department of Public Safety. The adopted FY 2005/2006 Budget continued the grant funds for a portion of the Patrol Watch Command position.

The financial plan for the Police Services Augmentation Fund reflects revenue only for FY 2006/2007 because the grants are speculative in nature. The Governor's State Budget for FY 2006/2007 includes the SLES program funded at the same level as

FY 2005/2006, so we have included that amount in our projections. Based on the combined funding from the SLES and BJA grants, reserves in the Fund will be totally depleted during FY 2006/2007 and available monies will only be able to support approximately 78% of the Patrol Watch Command position. Vacancies and other savings from Public Safety General Fund operations make up the difference in hours.

If the grant funds go away or are reduced significantly, it is important to note that a Patrol Watch Command position will be reduced accordingly from the Department of Public Safety Budget.

Employment Development Fund

The City of Sunnyvale, as administrative entity for the North Valley (NOVA) Job Training Consortium, is required by legislation and regulations to account for the use of various Federal and State funds and program revenues for the workforce development activities that are conducted for the consortium. The City has established the Employment Development Fund to fulfill this obligation.

NOVA, formed in 1983, serves the cities of Cupertino, Los Altos, Milpitas, Mountain View, Palo Alto, Santa Clara and Sunnyvale, and is administered by the Department of Employment Development of the City of Sunnyvale. NOVA has a wide variety of programs funded through various vehicles, with baseline funding originating from the Federal government and passing through the State of California. A significant amount of additional grant money is received from Federal and State sources, as well as the County of Santa Clara, local companies and foundations. Since July 1, 2000 the primary funding for the Department of Employment Development/NOVA has originated from the Federal Workforce Investment Act (WIA) appropriations.

In FY 2005/2006 grant application success rate and anticipated funding met expectations and budget plans.

The WIA-allocated funds for NOVA for FY 2006/2007 have not been released by the federal government for the State of California and, consequentially, the state has not been able to release local allocations. The reason behind the delay is that 2006 is the first year the Bureau of Labor Statistics (BLS) is using 2000 Census data for determining areas that have higher densities of unemployment, a factor in the WIA allocation formula. (1990 data was used as the basis for prior years.) Due to some changes in calculating the formula, when the numbers were originally run many states were disproportionately affected and the degree of change was determined to be too significant and too much the result of the change in formula versus the change in demographic. Thus, BLS has asked states to rerun their numbers based on 1990 Census data, and this exercise will mean a further delay in making the states' allocations.

Since WIA has a "hold harmless" funding factor that guarantees that states and local areas will receive at least 90% of their prior year share of the funding, the Federal government is appropriating that amount of funding at this time, and plans to supplement the grant awards in or about July, 2006 when the new calculations are completed. Thus the City is planning on the allocated funds for NOVA being reduced by as much as 10% for FY 2006/2007. To supplement these allocated funds, NOVA has a long history of being very competitive for additional Federal and State resources and has several grant applications in place. It is projected that at least $6 million in supplemental funding will be secured during FY 2005/2006. As in the past, staff will monitor the actual expenditure/revenue rates on an on-going basis and make the required adjustments as needed.

For the purposes of the City's recommended FY 2006/2007 Budget, we have taken the total funds that were available in FY 2005/2006 and used these as a starting point for NOVA's FY 2006/2007 programs and service levels. It is important to note that, as different grants come and go, various programs and activities operated by NOVA have a short lifespan relative to programs operated by other City departments. Therefore, the current listings of programs that have been operated by NOVA during the last several years are not included in this recommended Budget. Rather, a base funding level will be carried into the new fiscal year and the City Budget will be modified for planned activities, outcomes and expenditures during the course of the year as new funding is secured and new contract goals and obligations are agreed upon.

In FY 2005/2006, staff completed an indirect cost allocation plan that is in conformance with the requirements of the Office of Management and Budget (OMB) Circular A-87, "Cost Principles for State and Local Governments." The indirect cost allocation plan allows the City to recover the indirect costs associated with administering the NOVA grant programs including accounting, purchasing, and personnel services. Based on the plan, NOVA programs have been charged an indirect cost rate of 1.215% of expenditures beginning with the recommended FY 2006/2007 Budget.

Volume II, Operating Budget, contains descriptions of the significant NOVA programs and a summary table of the expenditures and budgets for these programs. As in the past and in keeping with the City policy for grant-funded programs, the Employment Development Fund Long-Term Financial Plan reflects grant revenues only for the immediate planning period.

Parking District Fund

The Parking District Fund is a small fund that provides for the ongoing maintenance of downtown parking lots. The Downtown Parking District includes all public parking in the downtown area with the exception of the parking provided by the Sunnyvale Town Center. Debt previously issued to purchase land and make improvements in the District was completely paid in FY 2003/2004.

The approval of Proposition 218 had a significant effect on the methodologies utilized to raise assessments to fund maintenance and operations within the Parking District. Proposition 218 not only deals with the approach and methodologies to be used for benefit assessments, but also the approval process. Essentially, after a method has been selected, a vote occurs by those who would be assessed, with votes weighted according to the amount of assessment. If this weighted majority does not approve the assessment, then it does not go forward. This financial plan assumes that the District will approve two-year term assessments on an ongoing basis. It also assumes that the amount will remain the same as the base year of FY 2004/2005.

The amount of the assessment generated in this manner will not be enough to pay actual operating expenses to maintain the District lots at the current level. The financial plan assumes that the 20-Year Resource Allocation Plan Reserve will be drawn down until FY 2010/2011 to sustain the existing level of service. After that time, assessments will have to be raised to meet the service requirements. The amount needed is shown as *Additional Special Assessment Required* on the Long Term Financial Plan.

In addition to operating costs for landscape and parking lot maintenance and for administration of the district, this Fund has a continuing special project to pay for costs of calculating and implementing the annual assessments. Since the assessment is assumed to be a two-year process, the special project for FY 2006/2007 contains a smaller amount to pay only for the charges by the County of Santa Clara for placing the assessment on the Property Tax roles. For FY 2007/2008 $17,500 is budgeted for the assessment engineer and the County charges. This alternating pattern continues for the remainder of the financial plan.

In the near future, the various new developments now occurring or planned in the downtown area are likely to change the character of the parking assessment district. Once all of the various factors related to parking in the downtown are defined and stabilized, the Parking District may be reconfigured considerably.

It should be noted that the lot located on the corner of Charles Street and Evelyn Avenue is not included in the maintenance assessment and will not be maintained with Parking District Funds. Costs of maintaining this lot are currently reflected in the Public Parking Lot Maintenance operating program. Although this lot was acquired with parking district bonds, it was not effectively serving the properties within the parking district. Parking District property owners expressed concern that it was primarily used by CalTrain riders, and in FY 2001/2002 the costs of maintaining it were removed from the Parking Maintenance District Assessment.

Two issues regarding the Parking District Fund must be stressed. First, <u>the level of service in this area is set by the property owners, not by the City</u>. Depending upon their desire for various services and their willingness to pay, the Parking District members can have more or less services included in their assessment. The second important issue concerning the Downtown Parking District is the <u>continuing threat that the voters will not approve the assessments at some point in time</u>. The assessment is currently up for renewal for FY 2006/2007. If the assessment is not approved any time in the future, funds will not be available for continued operation of the District and it would be necessary for staff to explore other potential revenue raising possibilities. These possibilities include establishment of a Parking Improvement District or Business Improvement District or even paid parking.

<u>Youth and Neighborhood Services Fund</u>

The Youth and Neighborhood Services Fund accounts for the revenues and ongoing operating program expenditures associated with the management and maintenance of the Columbia Neighborhood Center ("CNC"). On May 10, 1994 Council approved development of a neighborhood service center at Columbia Middle School to meet the health, social, recreational, and educational needs of North Sunnyvale residents (with an emphasis on serving disadvantaged youth) through a coordinated network of services. Advanced Micro Devices contributed $1 million to the Columbia Neighborhood Center project, one-half of which Council used to establish the Youth Opportunity Fund (now renamed the Youth and Neighborhood Services Fund) to generate interest to help offset ongoing operating program expenditures. Subsequently included in the ongoing fund balance were contributions made to the City in the amount of $6,658 on behalf of former employees that bring the current endowment total to $506,658.

At this time, only the operating program expenditures and Columbia Neighborhood Center related projects are in this fund along with the associated program revenues. As outlined in the partnership agreement, the City is reimbursed by the Sunnyvale School District for a portion of the cost of services provided at the Columbia Neighborhood Center. For FY 2006/2007 this reimbursement is projected at $110,250. Other revenues to the Fund are Recreation Fees, Rental fees for the facilities, interest earnings on the endowment, and an annual subsidy from the General Fund.

As part of the overall restructuring of the Budget this year, certain changes were made to the Columbia Neighborhood Center program to more accurately align the services and expenses provided. Previously, funds for recreation and youth and neighborhood safety services were budgeted in the CNC program but managed by Recreation and Public Safety staff. In FY 2006/2007 the funds are budgeted in the CNC program and the CNC site manager will be managing the services provided.

Additionally, certain Recreation fees and expenses for programs that were citywide in nature (i.e. co-op sports and adult and youth basketball leagues) were returned to the Community Recreation Fund to more properly reflect service responsibility. The FY 2006/2007 Financial Plan therefore shows a decrease in Recreation Fees for the Youth and Neighborhood Services Fund.

There is an increase in the FY 2006/2007 Financial Plan for youth and neighborhood safety services, due in part to the CNC staffing hours associated with directly administering these activities. Also, Public Safety staff has reviewed their prior activities in the Columbia Neighborhood and are planning efforts to more effectively engage at-risk youth and their parents. Staff will require more hours to implement these efforts, such as positive after school activities for youth and safety workshops for parents and community members.

The Office of the City Manager is restructuring positions in the department that include staffing changes in the Columbia Neighborhood Center. A new position, the Youth and Family Resources Manager (replaces the existing CNC Manager position), will manage both the Columbia Neighborhood Center and the Youth, Family and Child Care Resources programs. A part-time Administrative Analyst, of which 900 hours will be reimbursed by the Sunnyvale School District, will aid in supporting the operations of the Center and in bringing some services from Youth, Family and Child

Care Resources to Columbia Neighborhood Center. A quarter-time Sr. Office Assistant will provide additional reception support to the Columbia Neighborhood Center as well.

These changes have been reflected in the recommended FY 2006/2007 Long Term Financial Plan for the Youth and Neighborhood Services Fund.

For FY 2005/2006, the General Fund subsidy was approximately $245,000 and the Center drew down on existing available reserves by $102,831. For FY 2006/2007, the subsidy is set at about $491,000 and it grows with inflation over the entire planning period.

Redevelopment Agency Fund

The Redevelopment Agency is a separate governmental and legal entity from the City. However, the Agency is a component unit of the City for which the City is financially responsible. Further, due to certain agreements between the Redevelopment Agency and the City, the General Fund of the City is inextricably tied to the financial condition of the Redevelopment Agency.

At the close of FY 2004/2005 the Redevelopment Agency had two outstanding loans due to the City General Fund totaling approximately $51.2 million. This is largely the result of the Redevelopment Agency's inability to raise sufficient tax increment revenue to repay the City for annual lease payments made by the City for the downtown parking structure. The Agency entered into a First Amended Repayment Contract with the General Fund in 1977 to repay the debt associated with initial improvements to the Project Area and its inability to make payments on the parking structure. This Contract constitutes the "1977" loan. In 1986 certain State legislation imposed more stringent requirements on funds advanced by the General Fund to the Redevelopment Agency and a separate loan was created to account for costs subject to these restrictions. This loan is referred to as the "1986 loan."

Since the inception of the Redevelopment Project, the State has enacted several laws that placed revenue restrictions on redevelopment agencies. These include capping the time period for collection of tax increment for each redevelopment project area. The original termination date was November 2025. In FY 2004/2005, the plan was extended by one year per SB1044 in compensation for the RDA's ERAF payment in FY 2003/2004. The plan was extended for another two years in FY 2005/2006 per SB1096 for compensation of the RDA's ERAF payments made in FY 2004/2005 and FY 2005/2006. For Sunnyvale's project area, the termination date is now November 2028.

More important was the establishment of revenue limits for redevelopment agencies, referred to as Property Tax increment caps. The revenue limit/increment cap for the Sunnyvale Redevelopment Agency as originally established was $118 million. In FY 2005/2006 the Agency amended its Redevelopment Plan to increase the tax increment cap to $600 million. Increasing the cap will allow the Agency to receive an estimated $219 million by the end of the Financial Plan.

It should be noted that when tax increment received by the Agency reaches the original $118 million cap, certain pass through payments to other taxing entities will be required. These pass throughs, which are taken directly from the tax increment before we receive it, will begin in FY 2015/2016 and are shown at the bottom of the Long Term Financial Plan as *20% Pass Through to Taxing Agencies*.

An actual deposit to the RDA Low and Moderate Income Housing Fund will also be required when the 1977 General Fund loan is paid off as estimated in FY 2017/2018. Starting in FY 2017/2018, the Long Term Financial Plan reflects the 20% Low and Moderate Income Housing set-aside as a separate revenue line, with a corresponding expenditure for transfer to the City's Housing Fund where the housing projects will be managed.

When tax increment revenues from the downtown area as it originally existed were projected, the Agency reached its $118 million increment limit just before the time limit was reached in 2025. However, two major developments in the downtown area will cause the original tax increment limit to be reached earlier.

The first development is the 460,000 square foot Mozart office project at Mathilda and Washington. Because the buildings are complete, the City has begun to receive tax increment resulting from the project.

The recommended FY 2006/2007 Budget for the Redevelopment Agency also includes the redevelopment of the Sunnyvale Town Center Mall by the Forum Development Group. This major project, which was scheduled to begin in late 2004 and be completed within two years, has been delayed. Projections of tax increment is being moved back by one year, with approximately one-half of the total new value realized during FY 2008/2009 and the full value shown starting in FY 2009/2010.

As part of the Disposition, Development, and Owner Participation Agreement (DDOPA) signed with the Town Center developer in August 2004, the Agency has agreed to return to the developer up to $4,050,000 per year of Tax Increment plus 50% of any receipts above this amount, in return for construction by the developer of public streets and parking, including 1,442 underground parking spaces. This agreement reflects on the RDA Long Term Financial Plan as *Repayment to City – Town Center Developer*, since the mechanism for making the payments will be repayment of the General Fund loan. On the General Fund Long Term Financial Plan, a corresponding revenue is shown and an expense item that shows *Payment to Town Center Developer.*

The primary source of revenues to the Redevelopment Agency is Property Tax increment, which is expected to total about $3.8 million in FY 2006/2007. As mentioned above, Property Tax increment for the redeveloped Town Center Mall will almost double this source of revenue by FY 2009/2010. To facilitate an understanding of the development deal with Forum, the Property Tax increment projected to be generated by the Town Center Mall has been identified separately from the base Property Tax increment.

The other major revenue source for this fund is a lease payment from the General Fund for the Mathilda Avenue Parking Structure in the amount of $1.2 million annually.

Administration of the Redevelopment Agency, which is managed by the Community Development Department, is reflected in the RDA Fund in the amount of $186,752 for FY 2006/2007.

Included in current requirements are debt service payments totaling $1.7 million for the Central Core Redevelopment Project Tax Allocation Bonds and the Parking Facility Certificates of Participation. It is now projected that the Parking Facility COPs will be repaid by FY 2017/2018 and the Central Core TABs will be repaid in FY 2022/2023.

The Long Term Financial Plan also includes a repayment to the City for its outstanding loans (as discussed above) in the amount of $1.8 million in FY 2006/2007. The Plan includes a total of $37 million in repayment to the General Fund, not including the repayment related to the Town Center developer, over the first ten years and $38 million in the second ten years. The RDA Long Term Financial Plan assumes that funds available after paying debt service, projects and operating costs are used to pay the existing loan advanced by the City General Fund.

Even with all available funds, it is anticipated the RDA will not be able to fully repay the General Fund its principal and interest by 2028 when the tax increment revenues end. At the end of the redevelopment project life, it is estimated that the 1977 Loan will be paid off and the balance on the 1986 loan will be approximately $167 million.

$55,000 is programmed for the following Special Projects in FY 2006/2007:

- **RDA Project Area Economic Analysis**. This project has appropriations of $25,000 annually from FY 2005/2006 to FY 2007/2008. For FY 2006/2007 the funds will be used for economic analysis of the redevelopment of Town & Country Village. Efforts include but are not limited to: architectural studies and reviews, land planning, economic/market feasibility, parking analyses, and financial analyses to implement redevelopment in the downtown.

- **RDA Five Year Implementation Plan and Mid Term Review**: This project includes the professional services required to prepare and adopt the Redevelopment Five Year Implementation Plan and Mid Term review. Appropriations of $5,000 in FY 2006/2007 are for the Mid-Term Review and $21,224 in FY 2009/2010 for the Five Year Plan Update. The Implementation plan covers anticipated redevelopment activities over the next five years. A new Implementation Plan and a Mid Term Review is required every five years per the California Community Redevelopment Law (Health and Safety Code section 33490). The plan must describe specific goals and objectives of the Redevelopment Agency, specific programs, including potential projects, estimated expenditures to be made during the five year period, and how these projects will improve or alleviate blighting conditions in the project area. It must also contain a section on the Agency's housing responsibility.

- **Outside Counsel Services for RDA**: This project, which has appropriations of $25,000 for FY 2006/2007 and $25,500 for FY 2007/2008, supports the as-needed routine legal work and future project planning for the Agency. The

Agency contracts for legal service with a law firm that specializes in redevelopment law.

Capital Projects in the amount of $1,205,000 are recommended for FY 2006/2007:

- **Downtown Wayfinding System:** This project will develop a unified and clear signage program that directs the public within the downtown area as it is revitalized and evolves with new development and more uses. A coordinated signage program will improve the aesthetic and promote economic viability of the downtown. $250,000 is budgeted for FY 2006/2007.

- **Murphy Avenue Enhancements**: Funds in the amount of $260,000 are planned for FY 2006/2007 to "freshen up" Murphy Avenue. The first action will include planning for the future of the 100 block of historic South. Murphy. The project extends along the frontage of the 100 block of South. Murphy Avenue, the north side of Washington from Frances to Sunnyvale Avenue, and on the south side of Evelyn from the parking lot exit to Murphy Avenue. Phase I improvements include repairing concrete and replacing pavers; adding tree grates to existing trees; removing free-standing planters and landscaped areas and replacing with updated landscaping protected by a low iron rail; and painting street lights.

- **Downtown Block 2 Completion:** This project provides $695,000 in FY 2006/2007 to complete the segments of Block 2 that are not part of the historic Murphy Avenue or the Frances Street Transit enhancements. Options include updating features to the Downtown standard, adding new sidewalk and pavers, new planter areas, replacing street lights with the black acorn style electorliers, and installing bicycle racks, trees and tree grates. Four segments include Frances, Evelyn East and West of Murphy and Sunnyvale Ave.

One final ongoing expenditure is programmed in the Redevelopment Agency Fund to pay the General Fund for the services of the Agency's Treasurer and related support costs. These services are not charged directly to the RDA Fund, but rather are included in the General Fund and are shown as General Fund In-Lieu payments.

The Redevelopment Agency Fund maintains one reserve that reflects Debt Service Reserve Funds held by the trustees for the two outstanding bond issues mentioned above. Funds in an additional reserve for Capital Projects, which accounted for funds that were programmed for demolition of the Mathilda Avenue Parking Structure, have been depleted with completion of that project.

Finally, it should be noted that the Redevelopment Agency is currently unable to make payments of 20% of its tax increment revenues to the Low and Moderate Income Housing Fund because of preexisting debt obligations. Each year, the Agency calculates the contribution that should have been made and books it as a liability in its financial statements. It is currently estimated that when the tax increment cap is reached the liability will total approximately $24.4 million. State law allows the Agency to continue collecting tax increment after the Project time and increment limits are reached to fund its housing liability. Repayments of the Housing liability are anticipated to begin in FY 2028/2029.

Patent Library Fund

Since 1963, the City has hosted a Patent and Trademark Depository Library (PTDL) through the Sunnyvale Library. In 1994, the City partnered with the United States Patent and Trademark Office (USPTO) to deliver enhanced intellectual property services on a cost recovery basis. The partnership was known as the Sunnyvale Center for Innovation Invention and Ideas, or Sc[i]^3. The Patent Library Fund was established at that time to account for the partnership activities.

Over the years, it has been a challenge to operate the Sc[i]^3 partnership and fully recover its costs. Staff has consistently made efforts to deliver quality services to meet the needs and interests of the intellectual property community while controlling associated costs. In the early years of the partnership, the Sc[i]^3 Advisory Board, a group of interested parties, were gathered together to advise staff and brainstorm ideas about services and effective outreach methods. In 2001, the Friends of Sc[i]^3 which is also known as the Sc[i]^3 Foundation, was formed as a tax exempt foundation to assist Sc[i]^3 by raising funds for the program.

Despite these various efforts, the Sc[i]^3 partnership has never been able to achieve cost recovery. In May 2004, Council gave preliminary direction to cease the subsidy of the Sc[i]^3 program as of June 30, 2005. In November of 2004, Council delayed this decision and accepted the proposal from the Friends of Sc[i]^3 to increase their fundraising efforts to help eliminate the subsidy. At that time, Council indicated that if enough alternative funds were identified, continuation of the program could be considered. Subsequently, in March 2005 the Friends of Sc[i]^3 proposed that Sc[i]^3 be moved to Cogswell College. Council voted to continue operating Sc[i]^3 temporarily in order to give the Friends of Sc[i]^3 additional time to work with the USPTO to implement this new, proposed alternative service model.

In order to continue the program at the Sunnyvale Library in the meantime, Council approved a subsidy up to $53,000 through June 30, 2006. Since Summer 2005, the Sc[i]^3 Foundation and Library staff have made numerous attempts to obtain approval from the USPTO for the proposed move. While the USPTO has made no official response specific to the Cogswell proposal, they did engage in conversations with Council representatives in Washington, D.C. in March 2006 about partnership matters. As a follow-up to the meeting, the USPTO sent a letter to the City acknowledging Sunnyvale's subsidy for Sc[i]^3 and indicating that the USPTO is also bearing a subsidy of $90,000 of its own for Sc[i]^3 services. The letter stated that the USPTO is in agreement that the time may be right for Sunnyvale to transition from the Partnership Library relationship to a Patent Trademark Depository Library relationship.

Due to the ongoing financial risk to the City and the USPTO, and given the response from the USPTO, in March 2006 Council directed the Sc[i]^3 partnership be eliminated as of June 30, 2006. Additionally, to recognize the importance of the intellectual property activities in Sunnyvale and the Silicon Valley region, the City will continue to operate a Patent and Trademark Depository Library. Council also approved a $5,000 operating budget beginning in FY 2006/2007 for this purpose.

The recommended FY 2006/2007 Long Term Financial Plan for the Patent Library Fund reflects the decision to phase out operations of Sc[i]³ by the end of FY 2005/2006. It is projected that a small amount of fund balance remaining at June 30, 2006 will be transferred back to the General Fund as reimbursement, in small part, for the ongoing subsidy.

Transportation Development Act (TDA) Fund

In FY 2003/2004 a new, small special revenue fund was established to account for activities related to the Transportation Development Act (TDA) funds received from the State of California through the Metropolitan Transportation Commission. These funds are restricted for pedestrian and bicycle facilities and bicycle safety education programs and must be segregated for those purposes. In the past these funds were accounted for in the Gas Tax Fund. Although many of the projects using TDA monies are multi-funded by Gas Tax, TDA and other funding sources, they are completely different sources of funds and should not be reported in the same fund. In addition, the TDA, in accordance with Public Utilities Code Section 99245, must submit a report of a fiscal and compliance audit made by an independent auditor at the end of each fiscal year. In order to facilitate the audit and the issuance of the fiscal and compliance report, the City decided to segregate this fund into its own special revenue fund.

The recommended FY 2006/2007 Budget includes revenues of approximately $80,000 annually from TDA funds based on staff's estimates using historical receipts. This revenue is included each year for the entire 20-year period, increased by inflation.

For FY 2006/2007 a transfer of $62,148 to the Gas Tax Fund is proposed for the Java Drive Bridge project. The remaining fund balance of $23,970 are programmed to an expenditure line item entitled "Future TDA Projects." This expenditure line item continues each year throughout the Long Term Financial Plan. When the funds are received, pedestrian and bicycle projects will be identified and funds will be appropriated. Examples of projects funded to date are Arques Avenue Bike Lanes, Sunnyvale Bicycle Network, Calabazas Creek Trail, and the Borregas Bicycle Corridor.

CAPITAL PROJECTS FUNDS

Capital Projects Funds are used for major capital acquisition, construction activities, and renovation or replacement of General City fixed assets. The City currently operates two of these funds: the Capital Projects Fund and the Infrastructure Renovation and Replacement Fund. Capital and Infrastructure projects related to the Utility Enterprise Funds are budgeted and accounted for within each individual utility fund.

Capital Projects Fund

The Capital Projects Fund was established in FY 1997/1998 to account for capital projects that are funded by the General Fund and other governmental funds or that are funded by multiple sources. The Capital Projects Fund is divided into distinct sub-funds that receive direct transfers from the funds that are responsible for the particular projects. Each sub-fund records revenues, interest earnings, transfers and expenses separately.

The recommended FY 2006/2007 Budget includes four sub-funds of the Capital Projects Fund: the General Sub-fund, the Gas Tax Sub-fund, the Traffic Mitigation Sub-fund, and the Traffic Impact Sub-fund. In FY 2004/2005 staff changed the accounting method for capital projects related to the Utility Enterprise Funds to reflect best accounting practices. In keeping with this change, all monies that were held in the Capital Projects Fund for utility projects were transferred back to the Water Fund and the Wastewater Fund. All utility projects are now completely budgeted and accounted for within each Utility Enterprise Fund and the Capital Projects Fund will be used exclusively for the General Fund and other Governmental Funds. The only Utility Enterprise Funds that will still be budgeted here will be those that are relating to projects funded by more than one fund.

The Capital Projects Fund contains projects that are funded by federal and state granting agencies, developer contributions, and transfers from various City governmental funds. In FY 2003/2004 and FY 2004/2005, significant transfers were made from the Park Dedication Fund, primarily to support the Plaza del Sol Project.

Major project efforts included in the Capital Projects Fund are discussed throughout this Transmittal Letter under their applicable funding source. The table below is an overview of project appropriations by sub-fund for FY 2006/2007.

Capital Projects Fund - Project Expenditures by Sub-fund	
Sub-fund	**FY 2006/2007 Recommended Budget**
General Fund Assets	0
Gas Tax	1,248,045
Traffic Mitigation	365,000
Traffic Impact	0
TOTAL	**1,613,045**

The appropriations for the Gas Tax Sub-Fund are comprised of two projects. The first is the Roadway Rehabilitation on Various Streets (Grant) project ($1,157,645) and the Transportation Grant Matching Funds ($90,400). The Roadway Rehabilitation on Various Streets (Grant) project will rehabilitate portions of Fair Oaks Avenue, Mary Avenue, Hollenbeck Road and Kifer Road that have fallen below acceptable pavement condition standards. This project is funded by $1,035,183 federal ISTEA grant and $122,462 in Gas Tax monies as matching funds for FY 2006/07.

The appropriation for the Traffic Mitigation Fund is for the Future Traffic Signal Construction/Modification project. This project involves making major signal modifications and/or installing new traffic signals that may be necessary.

FY 2006/2007 is an "off" year for capital projects in the City's budgetary cycle. As such, there are no new projects recommended for funding in the ten year planning period.

Infrastructure Renovation and Replacement Fund

The Infrastructure Renovation and Replacement Fund was introduced with the FY 1996/1997 Budget and Ten-Year Resource Allocation Plan. Its importance has grown with each subsequent year as staff identifies projects to address the City's need to fund the renovation and replacement of its extensive physical infrastructure. This growth will continue until staff completes the Long-Range Infrastructure Plan (LRIP).

Similar to the Capital Projects Fund, this fund is divided into distinct sub-funds that receive direct transfers from the funds that are responsible for the particular infrastructure projects. Each sub-fund records revenues, interest earnings, transfers and expenses separately. Currently the sub-funds are General, Community Recreation, and Multi-funded Assets. Infrastructure projects for the City's three utilities are budgeted and accounted for in each utility fund in accordance with governmental accounting principles.

Major projects contained in this fund are described throughout the Transmittal Letter. The following table contains project expenditures by sub-fund for FY 2006/2007.

Infrastructure Fund – Project Expenditures by Sub-fund

Sub-fund	FY 2006/2007 Recommended Budget
General Fund Assets	1,493,085
Community Recreation	392,000
Multi-Funded Assets	129,445
TOTAL	**2,014,530**

There are 18 projects in the sub-funds consisting of such items as Corporation Yard Building HVAC repair and Traffic Signal Controller Replacement. The largest project is Traffic Signal Underground Replacement for $397,487. Information on each of the projects is available in the *Volume III, Projects Budget*.

A complete discussion of the total Infrastructure Renovation and Replacement Program and its current status is contained earlier in this Transmittal Letter in the *Major Project Efforts* section.

INTERNAL SERVICE FUNDS

The City utilizes internal service funds to account for the financing of goods and services provided by one department or agency to other departments or agencies of the City. There are two such funds that operate on a cost reimbursement basis: the

General Services Fund and the Employee Benefits and Insurance Fund. Both of these funds play an important role in the overall ability of the City to conduct business. Sunnyvale's full cost accounting methodology results in all of the costs of these funds being charged back to user activities on a rental rate or additive rate basis. Therefore, the total expenditures of these two funds are not added to the overall budget.

The City also has two additional internal service funds. One of the funds accounts for activities associated with the Sunnyvale Office Center and the other fund was created to separate property and liability insurance costs from the Employee Benefits and Insurance Fund.

General Services Fund

The General Services Fund provides a wide range of important support services to programs within the City. These services range from fleet, to building maintenance, to technology and communication services. Funding for these services is recovered through rental rates charged to benefiting program operating budgets. The rental rates may include not only the cost of operations, but also the cost of replacement for depreciable equipment. This assures the availability of funds to replace equipment at the most cost-effective time.

Aggregate rental rate increases for General Services Fund activities are projected at 3.7% for FY 2006/2007 and an average of 3.9% over the remaining first ten years of the General Service Long Term Financial Plan. Rental rates are lower in the second ten years of the Plan; however, it is important to note that the second ten years of the Long Term Financial Plan for the General Services Fund is considered by staff to be understated in terms of requirements. The reason for this is that there are expected to be some Capital and Special Project requirements during those years; however, those requirements are not well formed at this time. To partially mitigate this, a dollar amount equivalent to one percent of that year's annual rental rate was included in the Capital Projects line item for the Fleet Services Sub-fund, the Facilities Services Sub-fund, and the Technology/Application Services Sub-fund. While this provides some visibility to the expected increases in requirements over the last ten years of the Long Range Financial Plan, those last ten years are still likely understated, which increases the chance that rental rates in those years will need to be increased over their current expected levels.

During the development of the FY 2005/2006 rental rates, staff identified potential savings from the reduction of some of the City's general service equipment. A physical assets inventory for facilities services and technology and communications services programs was started during this current fiscal year. Preliminary results from the inventory project identified reductions in equipment expenditures for the technology and communications services program; these reductions have been implemented in the FY 2006/2007 Long Term Financial Plan. The physical assets inventory project will conclude in FY 2006/2007, and any additional savings that are identified will be included in the FY 2007/2008 Plan.

Additionally, in order to stabilize rental rates and avoid large year-over-year increases, the three sub-funds that have operational aspects, Fleet Services, Facilities Services, and Technology and Communications Services, were each allowed to have a negative reserve balance at some point during the Long Term Financial Plan. In aggregate, the combined reserve of these three sub-funds always remains positive; however, each fund may run a negative balance in order to maintain stable rental rate increases while absorbing peak years in operating and/or equipment expenditures.

There are a number of sub-funds within the General Services Fund in order to recognize distinct support service functions and establish appropriate rental rates for each. Included in each section is a brief description of major items that affect the current resources, current requirements, or reserves of each plan.

Fleet Services Sub-fund

The Fleet Services program reflects the cost of ownership of City vehicles and equipment. A primary objective of Fleet Services is to provide rental rates that are competitive with those offered in the private sector.

The main source of funding within this Sub-fund is derived from Fleet Services rentals to other programs. However, other items that affect the current resources of this fund are also discussed below.

The Fleet Services rental is scheduled to increase by 3.0% for FY 2006/2007, or $100,607, above the current fiscal year. Fleet Services rentals will continue to grow at a rate of 3.0% annually for the remainder of the first ten years of the Long Term Financial Plan.

The Sale of Property line item of the Financial Plan represents the sale of surplus or replaced vehicles or pieces of equipment. The projection is based on historical averages for the surplusing of vehicles and equipment.

The Intrafund Loan Repayment represents scheduled payments from the Facilities Management Services Sub-fund. This loan was initially made in FY 1999/2000 to alleviate cash flow issues experienced by the Building Services Sub-fund. The initial terms of the loan were for a principal amount of $1.6 million to be repaid over 10 years with final payment scheduled for FY 2015/2016. The original terms of the loan have been modified to accommodate potential cash flow problems from the Facilities Management Services Sub-fund in the latter portion of the first ten years of the Long Range Financial Plan. The updated terms call for the loan to be repaid by FY 2016/2017.

The multiple transfer line items found within the Current Resources section of the financial plan represent the funding mechanisms for a Capital Project, which is Upgrading the City's Fuel Stations.

The two major current requirements deal with equipment replacement and operation of the Fleet Services Program.

The operations line reflects a minimal increase in FY 2006/2007 over the expected operations expense for FY 2005/2006. This increase is primarily attributable to higher fuel prices.

The Equipment Replacement Reserve represents the accumulation of annual rental rates received from City programs, net of replacements purchased during the current fiscal year, for future replacement of vehicles and equipment. This reserve correlates with the *Equipment Replacement* line item under the *Current Requirements* section of the sub-fund. For example, when a large value item is scheduled to be replaced such as a street sweeper or a fire apparatus, the equipment replacement reserve will be drawn down as the accumulated annual replacements fund within the reserve will be used to purchase the vehicle or apparatus.

The *20-Year RAP Reserve* functions in this fund, as in other funds, to levelize rates and plan for capital projects.

Facilities Services Sub-fund

The Facilities Services Program reflects the cost of maintaining City facilities (including costs for electricity and water), free standing furniture, modular furniture, and building equipment.

The Facilities Services Sub-fund has two rental rate revenue items, one relating to space rental and the other relating to equipment. The space for Facilities rental is based upon the total square footage of building space throughout the City. This square footage is then divided amongst the various City programs. The equipment rental accounts for replacement costs associated with modular and freestanding furniture, carpet and blinds, and building maintenance equipment. Because the physical assets inventory is currently being conducted on Facilities Services furniture and equipment, FY 2006/2007 equipment rental amounts have been maintained for the Long Term Financial Plan. The physical assets inventory will be completed during FY 2006/2007 and the result will be an updated equipment inventory and replacement schedule. The new replacement schedule will allow for updated equipment expenditures to be included in the following year's Long Term Financial Plan.

For FY 2006/2007 the aggregate rental rate is scheduled to increase by approximately 4%, or $144,669, as compared to the current year.

The major current requirements deal with equipment replacement and operation of the Facilities Services Program. The increase in planned operating costs for FY 2006/2007 is primarily attributable to increases in utilities costs.

The Transfer to Sunnyvale Office Center line item in the Financial Plan represents a transfer of rental rate revenues received from City programs currently housed at the 505 W. Olive Sunnyvale Office Center. These funds are collected in this Sub-fund and then transferred to the Sunnyvale Office Center Sub-fund to partially fund the facility management costs associated with that facility.

The Interfund Loan line item in the financial plan represents loan payments to the Fleet Services Sub-fund. As was mentioned in the *Fleet Services* section, this loan was made to alleviate cash flow constraints of the Facilities Management Sub-fund in FY 1999/2000. The initial terms of the loan were for a principal amount of $1.6 million to be repaid over 10 years with final payment scheduled for FY 2015/2016. The original terms of the loan have been modified to accommodate potential cash flow problems from the Facilities Management Services Sub-fund in the latter portion of the first ten years of the Long Range Financial Plan. The updated terms call for the loan to be repaid by FY 2016/2017.

The Equipment Reserve represents the accumulation of annual equipment rental rates received from City programs, net of replacements purchased during the current fiscal year, for future replacement of office furniture, carpets and blinds, and building maintenance equipment.

The Operations/Other Reserve functions in this fund to identify the reserve without the equipment revenues and expenditures factored in to ensure operations expenditure overages are not subsidized by equipment resources, which had been an issue in previous years.

Technology/Application Services Sub-fund

The Technology/Application Services Sub-fund reflects the cost to operate and maintain the City's technology and communications program and infrastructure. This includes technology (hardware and software), communications, and office equipment.

For FY 2006/2007 the aggregate rental rate is scheduled to increase by approximately 4.3%, or $303,260, as compared to the current fiscal year. An average annual increase of approximately 4.3% is projected for the remainder of the first ten years of the Long Range Financial Plan.

The Miscellaneous Revenue line item in the Financial Plan accounts for royalty revenue received from the City's SUNGIS software application, as well as revenues received for a cost sharing agreement with Comcast for cable television franchise reviews that occur every five years.

Transfers in for FY 2010/2011 and FY 2011/2012 are for the planned replacement of the City's messaging and collaboration software. The on-going transfer from the General Fund represents funding for costs associated with management of the City's cable franchise agreement.

The major current requirements of this Sub-fund deal with equipment replacement and operation of the Technology Services Programs. Staff has pro-actively reduced the Equipment Technology line by 10% on an on-going basis to reflect the results of an extensive physical assets inventory that was undertaken in FY 2005/2006. This inventory of equipment technology assets yielded preliminary results indicating that inventory valuations were higher than necessary and that the useful life of equipment could be extended. This reduction is in addition to the 10% reduction that was implemented for the FY 2005/2006 Adopted Budget to account for the continued decline in hardware acquisition costs and anticipated reductions in the level of equipment to be replaced in future years.

The General Fund Loan Repayment line item of the Financial Plan represents the repayment schedule of a $2 million loan made to the former Technology Services Sub-fund in FY 1999/2000. This loan was made to fund a number of information technology initiatives including the City's geographical information system (GIS). The original term of the loan was 10 years with payments scheduled to begin in FY 2009/2010. Staff has accelerated the payment of this loan to begin payments in FY 2006/2007, with the loan scheduled to be paid off in FY 2012/2013.

The equipment replacement reserve represents the accumulation of annual rental rates received from City programs, net of replacements purchased during the current fiscal year, for future replacement and maintenance of network infrastructure, central computer maintenance, desktop maintenance, training, development of equipment specifications and/or applications, administrative and support services, technology equipment replacement costs, communication equipment, office equipment, mail services, print shop services, and telecommunication franchise (all KSUN related equipment).

The *20-Year RAP Reserve* functions in this fund, as in other funds, to levelize rates and provide for planned capital improvements.

Sewer Equipment Sub-fund

The Sewer General Services program has responsibility for all equipment at the Water Pollution Control Plant and all equipment for the wastewater collection system. These rental rates are applied exclusively to the Wastewater Management Fund. For FY 2006/2007 the rental rate is scheduled to remain flat in comparison to FY 2005/2006. An average annual increase of approximately 3% is projected for the remainder of the plan.

Public Safety Equipment Sub-fund

The Public Safety Department has responsibility for the General Services program that manages all fire and police service equipment. This equipment includes items such as guns, fire hose, and fire Self-Contained Breathing Apparatus (SCBA) units. Other equipment, such as fleet, radio, and computer equipment, is all handled through the respective city-wide General Services program. All rental rates are applied exclusively to Public Safety Programs within the General Fund. For FY 2006/2007 the rental rate is scheduled to remain flat in comparison to FY 2005/2006. The rental rates and equipment replacement schedule for the duration of the Long Term Financial Plan remain the same as the FY 2005/2006 values, as staff is in the midst of an extensive physical assets inventory project on Public Safety Department equipment. Results of the inventory, expected to be completed in FY 2006/2007 and implemented for the FY 2007/2008 budget, will yield an updated 20-year asset replacement schedule and will impact annual rental rates and equipment replacement cost projections.

The General Fund Loan repayment line item of the Long Term Financial Plan represents the repayment schedule of a $450,000 loan made in FY 2000/2001. This loan was made to help alleviate cash flow issues experienced by the Sub-fund at that time; specifically, these funds were used for replacement purchases of SCBA units. The original term of the loan was 9 years with an annual payment of $20,000 starting in FY 2007/2008 through FY2011/2012 and $243,659 starting in FY 2012/2013 until FY 2015/2016. Staff has increased the dollar amount of the first portion of the loan repayment; the loan is scheduled to be paid off in FY 2018/2019.

Parks and Recreation Equipment Sub-fund

The Parks and Recreation Department has responsibility for the General Services program that manages all leisure services equipment. Examples of this equipment include pool covers, theater lighting, gymnastic equipment, and theater staging equipment. All rental rates are applied exclusively to the Community Recreation Fund. For FY 2006/2007 the rental rate is scheduled to remain flat in comparison to FY 2005/2006. For the remainder of the first ten years of the Long Term Financial Plan the annual rental rate increase is 2.5%.

Project Management Sub-fund

The Project Management Sub-fund represents project management services provided by staff within the Department of Public Works Engineering Services Program. These services are associated with the various capital and special projects currently incorporated within the City's Projects budget. The transfers into this fund represent the proportionate share of the current schedule of projects that the project management group is responsible for overseeing.

Employee Benefits and Insurance Fund

The Employee Benefits and Insurance Fund provides a mechanism to cover expenditures related to pension costs, employee insurance plans, workers' compensation costs and leave time while applying the principles of full cost accounting. This is accomplished by charging an additive rate to staff salaries wherever personnel hours are budgeted and expended. To better track and analyze expenditures, the Fund is separated into four Sub-funds: Leaves Benefit, Retirement Benefits, Workers' Compensation and Insurance and Other Benefits. Liability and property insurance, previously a part of the Employee Benefits and Insurance Fund, was broken out into its own fund because these costs are not related to salary expenditures, but instead are recovered on claims experience and building space and fleet usage.

As part of the budget restructure process, the expenditures budgeted in the Employee Benefits and Insurance Fund were reviewed and it was determined that the costs related to the administration of benefits should be budgeted with the other Human Resources Department programs in the General Fund. This would provide better accountability, cleanly separating those costs program managers have control over and those they do not. These costs will continue to be recovered from the appropriate City Funds, but through the in-lieu charge for City administration costs rather than through the additive rate.

The employee benefits costs have experience sharp increases in recent years, primarily in retirement and medical premium costs. For FY 2006/2007, the combined fund total expenditures, excluding administration costs, are slightly up from FY 2005/2006, with a 1.5% increase. Last year, a 4% increase was budgeted for FY 2006/2007. The smaller than estimated increase is largely due to a decrease in the retirement contribution rate based on a new actuarial methodology from CalPERS and a smaller than estimated increase in the City's share of medical premium costs. While this is a positive fiscal impact for FY 2006/2007, uncertainty in the long term contribution rates for retirement, continued high increases in medical premiums, and growing retiree medical costs are some of the significant factors that are problematic for the long term financial picture. Details of the benefits changes are discussed in the Sub-fund sections below.

Leaves Benefit Sub-fund

The Leaves Benefit program accounts for all City employees' leave time, including accrual of leave benefits. The additive rate is calculated by determining the amount of leave benefits to be accrued and adjusting for estimated salary increases. Disability leave is budgeted based on historical usage and trend analysis. The budget anticipates a decrease in disability usage for FY 2006/2007 from FY 2005/2006 through better management of the disability program. The interest income in this Sub-fund is generated from the leave earned, which is expensed at the time it is earned and held as a liability in our General Ledger until it is taken.

Retirement Benefits Sub-fund

The Retirement Benefits Sub-fund contains the costs for the City's retirement plan. Sunnyvale contributes to two California Public Employees Retirement System (CalPERS) plans for and on behalf of its employees: Safety (3% @ 50 Plan) and Miscellaneous (2% @ 55 Plan). The City pays the employee contribution as well as the employer contribution for these plans. While the employee contribution rate is set by law, the employer contribution rate is adjusted by CalPERS through an actuarial analysis and is impacted by its investment portfolio. The contribution rates are applied against employee salaries (PERSable earnings) in order to calculate the dollar amounts the City must contribute. Employer rates provided by CalPERS for FY 2006/2007 are in the following table along with current and last year rates for reference. The last column shows the rates budgeted in the recommended budget.

CalPERS Plan Employer Rate	2004/2005 (actual)	2005/2006 (actual)	2006/2007 (actual)	2006/2007 (budgeted)
Safety (3% @ 50)	29.6%	32.9%	26.0%	28.6%
Miscellaneous (2% @ 55)	6.6%	11.4%	11.0%	11.4%

While the table indicates a decrease in rates, this is due to a new amortization schedule CalPERS has adopted for setting these rates. The new schedule is a 30-year rolling amortization that decreases rates, but creates a negative amortization of the unfunded actuarial liability so that the unfunded actuarial liability never gets paid off, but actually grows over time. In contrast, the previous method would pay off the unfunded actuarial liability at the end of 20 years or less. Because of this increase in the unfunded actuarial liability, the City obtained from CalPERS the contribution rates necessary in FY 2006/2007 so that the City's unfunded actuarial liability would not increase. Those rates are reflected in the last column of the table. These rates have been budgeted for FY 2006/2007 only. The remainder of the financial plan includes the CalPERS 30-year rolling amortization rates. Due to the volatility in CalPERS rates in recent years and the difficulty in projecting rates over the long term as a result, this provides staff an additional year to analyze the new methodology and determine the best approach for the City in both the short and long term. In addition, a *PERS Rate Uncertainty Reserve* has been created in this Sub-fund starting in FY 2007/2008 that will provide a modest amount to deal with some of the volatility in PERS rates.

The new contribution rates result in costs that are higher than budgeted for the miscellaneous plan and lower than budgeted for the safety plan over the twenty years. The new miscellaneous rates are higher than the current year rates in the first twelve years of the financial plan and slightly lower for the last eight years, with a net impact of $21 million more required over the twenty years. For the safety plan, the opposite has occurred. The new rates are lower than the current rates for the first ten years of the financial plan and then higher in the back ten years, with a net impact of $1.7 million more required over the twenty years.

As negotiated in the current Memorandum of Understanding with SEA, the Miscellaneous Plan will be enhanced effective FY 2007/2008 pending membership approval. The benefit will increase from 2% @ 55 to 2.7% @55. The exact impact to the employer contribution rate is not known since the health of the investment portfolio at that time will have an effect on the rates. However, during negotiations, CalPERS provided the City what the rate would be if the enhanced benefit were to go into effect at that time. The employer contribution rate would increase by approximately 6%, essentially doubling the current rate of 6.6%. To pay for these increased costs, SEA took a 0% salary increase for FY 2004/2005 and agreed to a revised salary formula which was anticipated to result in lower salary increases than budgeted for the next two years. These budgeted salary savings have been transferred from all the various operating programs to the Retirement Benefits Sub-fund. It should be stressed that if either the actual employer contribution rate or the SEA salary adjustments are higher than projected, the fiscal impact to the City could be substantial. The salary savings are currently in the *Enhanced Retirement Reserve* of this Sub-fund and will be drawn down when the enhancement takes effect.

Workers' Compensation Sub-fund

The Workers' Compensation Sub-fund is funded through the use of an additive rate that is applied to all staff salaries. This additive rate is based upon actual usage of the City's Workers' Compensation program. For this reason, the City charges a variable additive rate depending upon the classification of the employee. In other words, more high risk positions, such as a Public Safety Officer, are charged a higher rate than an administrative employee.

Significant reductions were made in the Workers' Compensation Program Budget for FY 2005/2006 to reflect staff efforts to reduce the controllable factors related to workers' compensation costs. Staff's goal was to reduce workers' compensation costs by 25% in FY 2005/2006 and an additional 25% over the next five years, for a total of 50%. Based on year to date data, it is estimated that staff will achieve the goal for FY 2005/2006. Staff has focused on injury prevention training, increased utilization of the light duty program and better management of and follow-up with employees out on workers' compensation. However, more work needs to be done to continue to meet the remaining targets. The recommended budget is unchanged, reflecting the targeted reductions over the next several years. Staff will be analyzing all aspects of the workers' compensation program in the next year to determine the best ways to contain costs over the long term. The analysis will also determine the appropriate reserve level needed, both in the short term and when the City has achieved its targeted reductions. In addition, as part of the budget restructure, all Departments now have a workers' compensation measure in their Department Management program.

As mentioned earlier, the costs associated with administering the workers' compensation program has been moved to a Human Resources benefits administration program in the General Fund for better accountability. In addition to staff costs, the wellness program budget has also been moved. The budget for the light duty program, which had funded public safety officers and lieutenants on light duty, has been moved to the Public Safety Management and Support Services Program.

The Worker's Compensation Sub-fund reserve requirement was based upon an initial reserve provided through actuarial analysis. The ending reserve requirement was based on the total obligation of the initial reserve in addition to the anticipated number of claims net of estimated payments for the fiscal year. Because the reserve requirement will be analyzed over the next year, the current reserve level has been held pending the results of the analysis.

Insurance and Other Benefits Sub-fund

The Insurance and Other Benefits Program includes costs for all the employee insurance plans including medical, dental, vision and life insurance. As with the other sub-funds, any costs for administering these programs have been moved to a Human Resources program in the General Fund.

The largest cost in this Program is medical insurance for our employees. The increase in health premiums for the City was slightly less than budgeted for calendar year 2006. The budgeted increase was 12% while the actual increase in premiums for the City's four healthcare plans ranged from 9.1% to 9.8%, with an average increase of 9.5%.

The budget for FY 2005/2006 took into account the change in ratio between the City's contribution for health premiums versus the employees' contribution due to the Memorandum of Understanding with the Sunnyvale Employees' Association that was adopted last year. Because the MOU increases the City's dollar contribution towards SEA employee healthcare costs, a fiscal impact was calculated based on some movement into more expensive medical plans. While the City’s contribution has increased, it has not been as much as originally calculated. The recommended budget has adjusted the City’s contribution accordingly. The recommended budget also incorporates the recently adopted MOU with Service Employees International Union (SEIU) which increases the City’s contributions for health premiums for the City’s part-time employees.

The long range projections include 12% increases in medical costs for FY 2006/2007, 8% for the next five years, and then 5% for the remainder of the Long Term Financial Plan. These are the same assumptions contained in the current budget.

A significant cost that is estimated to increase rapidly over the next years is the City’s share of retiree medical costs. Because the increase in healthcare premiums and the number of retirees is estimated to grow at a healthy pace, the City’s additive rates must be increased substantially in the second ten years of the financial plan to fully cover costs. As a result, the financial plan contains increases of 10% for one year and 7% for two years in the second half of the plan. Staff will be analyzing ways to contain medical costs for both active employees and retirees in the coming years.

The reserve in this Sub-fund has been separated into two for the recommended FY 2006/2007 Budget. The *Estimated Actuarial Retiree Medical Reserve* accounts for the estimated liability for the City’s retiree medical costs. Based on an actuarial study conducted in 2003, the liability was calculated to be 8.6% of total payroll. This calculation has been reflected in this reserve and grows with the estimated increase in salary expenditures. However, because the actuarial study was conducted several years ago, it does not take into account changes in contributions limits and any other changes to our medical plans. A new actuarial study will be conducted in FY 2006/2007, which will provide a more accurate calculation of our liability. The second reserve, *Insurance Rate Uncertainty*, provides funds for several uncertainties including: unanticipated changes in premium costs, adjustments in the City’s contribution costs, increases in the number of retirees beyond what has been estimated in the financial plan, and adjustments to the City’s liability for retiree medical costs. In addition to this reserve, this Sub-fund contains a *fiscal uncertainties* expenditure line item to provide additional funding for these uncertainties as well.

Liability and Property Insurance Fund

This fund was established to separate out liability and property insurance costs from the Employee Benefits and Insurance Fund. Separating these costs into a separate fund provides better accountability of expenditures and allows the City to recover costs based on usage rather than on salary expenditures.

The Liability Property Insurance Fund is funded through transfers from its dependent funds rather than on an additive rate basis. This insurance coverage is applied to the maintenance of the City's infrastructure and covers the City against claims such as a Trip and Fall, Vehicle Damage, and damage caused by City trees. Currently, the City participates in a risk pool administered by the California Joint Powers Risk Management Authority.

The administration of the Liability and Property Insurance Program has been transferred from the Human Resources Department to the Office of the City Attorney. As a result of this change and adjustments in staffing, administration costs have been reduced for FY 2006/2007.

The reserve level in this Fund has been reduced from FY 2004/2005 due to one large liability claim paid out in FY 2005/2006. In addition to the claims expense, the City received a smaller insurance rebate as a result as well. The transfers have been budgeted to build the reserve back over several years. The Office of the City Attorney will be reviewing the appropriate reserve level for this Fund in the next year. The reserve level will be adjusted for FY 2007/2008, pending the results of this analysis.

Reserve Levels in Employee Benefits and Insurance Fund

Reserves in the Employee Benefits and Insurance Fund have been set at amounts recently established by actuarial studies or staff analysis, as discussed above. The reserve levels as of June 30, 2006 are expected to be as follows:

Reserve Item	2005/2006 Year-End Amount
Workers' Compensation	$10,224,244
Enhanced Retirement	$3,207,402
Estimated Actuarial Retiree Medical	$6,695,000
Insurance Rate Uncertainty	$5,659,804
Liability and Property*	$164,702
Total Employee Benefits Fund Reserves	**$25,951,152**

**Liability and Property were separated into a new fund for FY 2002/2003.*

Sunnyvale Office Center Fund

This fund accounts for the activities of the Sunnyvale Office Center located at 505 W. Olive Avenue, across from the main City Hall. The Sunnyvale Office Center was purchased in April 2001 by the issuance of variable rate Certificates of Participation ("COPs") to provide expansion opportunities for the Civic Center Complex. Activities included in this fund are maintenance and operations of the office facility, capital projects, and debt service. Revenues to this fund consist of rental from outside tenants and City operations, and interest on reserves.

When the fund was established, it was projected that the existing office buildings would be operated and leased through FY 2005/2006, when a long-term solution to the City's office space problem could be in place. Subsequently, plans for a new civic center complex have been put on hold because of the City's financial situation. The

FY 2006/2007 Long Term Financial Plan therefore shows the complex being operated for the entire 20-year planning period. Increasing the length of operation causes the office complex to generate more net income than originally anticipated; this allows the Sunnyvale Office Center Fund to give a rebate to the General Fund of about $200,000, increasing with inflation, annually over the entire planning period.

Because of the age and general condition of the office buildings, it was necessary to propose capital improvements in the amount of $564,000 in order to keep the facility in working order for the additional years that it would be in operation. The capital improvements began in FY 2004/2005 and continue through FY 2007/2008. A similar set of capital improvements is proposed in starting in FY 2014/2015 through FY 2016/2017.

Staff has also modified the interest rate assumptions to account for the likely increase in interest rates in the near future. Currently, the COPs weekly interest rate is 3.12%. However, given recent indications from the Federal Reserve's Federal Open Market Committee that more interest increases are in store, staff has projected an assumed interest rate of 4.5% for FY 2006/2007. Starting FY 2007/2008 staff has projected the interest rate for the rest of the Financial Plan at 3.12%. This interest rate represents the approximate historical average of the Bond Market Association's Municipal Swap Index.

FIDUCIARY FUNDS

Dorolou P. Swirsky Youth Opportunity Fund

In August 1993, City Council accepted Dorolou Swirsky's intent to donate her house upon her death to provide an endowment to specifically address sports, recreational, social, cultural, and educational activities for disadvantaged youth living in Sunnyvale.

The Dorolou Swirsky Trust Estate was donated to the City upon her death in March 2000. The estate consisted of a single family home located at 1133 Hollenbeck Road. Following the donation, the City established the Swirsky Youth Opportunity Fund to account for the proceeds. Ms. Swirsky had taken a reverse mortgage on the property which the City paid upon her death using General Fund monies. The property was rented out until August 2003 with net proceeds used to help pay back the General Fund for the reverse mortgage.

In November 2003 Council approved a resolution authorizing the sale of 1133 Hollenbeck Road. The house was subsequently sold, the remainder of the General Fund advance was paid, and an endowment of $526,635 was established. In accordance with Council's action, one-third of the interest generated each year by the endowment was to be used to provide summer recreational equipment and supplies to disadvantaged youth through an agreement with Sunnyvale Community Services. Council also asked the Arts Commission and the Parks and Recreation Commission to explore how the City might grant the remaining two-thirds to outside agencies serving Sunnyvale's disadvantaged youth.

However, given the continuing budget shortfall and the costs involved with administering such a program, Council ultimately directed the City Manager to use the remaining two-thirds of the interest on the Swirsky Youth Opportunity Fund to supplement the City's Mobile Recreation Program or an equivalent City program rather than using the funds for grants to outside groups. The City Manager would include a recommendation for the use of funds (consistent with the Trust) with the budget submittal each year.

For FY 2006/2007, it is recommended that the full amount of interest be used to supplement the Mobile Recreation "Fun on the Run" Program and the agreement with Sunnyvale Community Services be revised to reflect this change. Last year these funds were used to add a sixth day of programming which allowed a stop at an elementary school on additional day each week.

Fremont Pool Endowment (Trust) Fund

The Fremont Pool Trust Fund was established by the City in FY 2002/2003 to account for the receipt of monies raised by The Friends of Fremont Pool, a group of residents who lobbied City Council regarding the need for a new pool in Sunnyvale. The Fund currently has an Endowment Reserve balance of $831,178. The basic premise of this fund is that the corpus, or principal, is never expended. Rather it is invested in a safe, interest-generating market. Each year the interest generated by this fund is transferred to the Community Recreation Fund to help offset the City's cost of operating the new, 50-meter pool constructed in partnership with the Fremont Union High School District at Fremont Union High School. The City has a contract with California Sports Center to program and operate the Fremont Pool on our behalf.

The City's cost is determined by adding 50% of the cost of maintaining the pool itself (performed by the School District, which subsequently bills the City), 100% of the City's cost of maintaining the public shower/locker facility, and staff costs related to oversight of the contract. The City's projected cost for Fremont Pool maintenance for FY 2006/2007, which is programmed in the Community Recreation Fund, is $129,010. Interest earnings on the Fremont Pool Trust Fund are projected to be $41,559. The Trust earnings pay approximately 32% of the City's annual costs. Revenues from operation of the Fremont Pool are projected to be $48,000 for FY 2006/2007, or 37% of total cost. The subsidy from the General Fund to the Community Recreation Fund makes up the difference.

It should also be noted that while the corpus of this fund may grow a bit in future years (assuming continued contributions), it is not expected to increase markedly over time. As a result, it is not expected to keep up with inflation and the purchasing power of the interest it generates will likely erode over time. In this context, and the City's current budget crisis, it is critical to note the importance of allowing the California Sports Center (CSC) to charge market rates for use of the pool. It is also important to allow the operator to determine effective, revenue producing programming as well. The net revenue received by the City from CSC, and the interest generated by the Fremont Pool Trust Fund, are critical factors in allowing the pool to support itself financially.

CONCLUSION

Sunnyvale's planning and financial management systems provide a strong foundation for the City's long term financial stability. Without this foundation, the City would likely find itself unprepared to respond to new fiscal realities. These systems give the City the time and methods for dealing with fiscal challenges in a measured and thoughtful way.

During good economic times, the preparation and adherence to basic fiscal policies and processes required to build this foundation can at times seem overly cautious, conservative, and time-consuming. However, the true value of the City's fiscal policies (and the rigors and self-discipline they require) are most evident during tough financial times, such as those the City has endured these last few years. During this time, the City has faced—and surmounted---unprecedented fiscal challenges.

While we can take a breather regarding our long term financial condition, given that the recommended FY 2006/2007 Budget is balanced and the General Fund structural gap that previously existed has been closed, the job is not over. A number of fiscal pressures have been identified that must be addressed in the coming years. Our economic condition continues to be evolving, and we will need to continue to pay close attention and make course corrections as necessary.

Most of all, Council will need to make courageous fiscal decisions while remaining responsive to community needs. Despite the forecast of better economic times, the foreseeable future will bring many more requests for new and increased service levels than the City can afford. Responding to these through application of the City's basic fiscal policies and processes, as well as a desire to meet the community's needs, will remain critical long after the economy has improved. Even during the best of times, this balanced fiscal approach serves to better prepare our foundation to withstand another downturn.

The City's approach to budgeting and long-term financial planning is complex, and highly valued in this organization and in our community. In preparing the recommended FY 2006/2007 Budget and Twenty-Year Resource Allocation Plan, I am fortunate to have had the support and assistance of exceptional staff who continually go beyond the call of duty.

The budget would not have been prepared without the talented and dedicated budget team led by Mary Bradley, Director of Finance and Grace Kim, Finance Manager. These team members, including Drew Corbett, Kurtis Mock, Charlene Sun and Tim Kirby, did a yeoman's job in putting the budget together and I greatly appreciate their dedication. My appreciation also goes to Assistant City Manager Robert Walker, who provided able assistance at every step of the budget process. Last but not least, all the Department Directors and their staff must be recognized for their support and tireless efforts in both the budget restructure process and the preparation of this two-year operating budget.

Finally, I would like to thank the Council for your leadership and commitment in long range financial planning. Your belief in Sunnyvale's Planning and Management System sets the tone for where we need to go as an organization. As a result, Sunnyvale is able to continue delivering the highest quality service at the lowest possible cost, ensuring the quality of life that the community has enjoyed and continues to expect.

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APPENDIX A

THE SUNNYVALE APPROACH TO BUDGETING

In reviewing the recommended FY 2006/2007 Budget and Twenty-Year Resource Allocation Plan, it is important to understand the key systems Sunnyvale uses to chart its future both in the good times and the bad times. Sunnyvale's approach to budget preparation is a central part of the City's Planning and Management System (PAMS). Key elements of the PAMS framework include:

- Long-range strategic planning (the General Plan Elements and Sub-Elements),
- Long-term financial planning (includes projections over a 20-year time frame for revenues, operations, projects, debt and reserves),
- Short-term allocation of resources (the two-year action budget),
- Performance measurement of service delivery,
- The Council Study Issues process,
- Performance "contracts" (priority setting) for Management,
- Annual performance reporting and evaluation, and
- Performance audits based on risk assessments.

This integrated framework has enabled the City, over time, to accomplish the long-range strategic goals established by the Council in the General Plan Elements and Sub-Elements. PAMS has assisted the City in maintaining, and even expanding, services during times of numerous Federal/State mandates and revenue restrictions or reductions because the focus is on long-term fiscal management. PAMS has also served as a valuable tool in producing and capturing remarkable gains in efficiency and productivity. It supports Sunnyvale's mission of providing the highest possible quality services with the lowest possible cost to its community.

The Fiscal Sub-Element of the General Plan requires that the City Manager annually propose a budget that is balanced not only for the budget year, but also for the Ten-Year Resource Allocation Plan. Since FY 1993/1994, Council has approved a financial plan that has been balanced to the twentieth year. The long-term nature of the City's financial planning system allows decision-makers to better understand the true effect of policy decisions. Because City practice has been to prepare a fully balanced 20-year financial plan, it effectively requires that decisions made today guarantee that the resources will be available to provide quality services in the future. The Twenty-Year Resource Allocation Plan prevents wild swings in service levels during the upturns and downturns of economic cycles.

Annual budget review and approval is a sound business practice and is required by the City Charter. However, an understanding of the City's long-term financial picture is more important to the process than just looking at a one-year or two-year snapshot. Therefore, much of the discussion in this Transmittal Letter focuses on long-term strategic planning and fiscal issues.

PERFORMANCE BASED BUDGETING

The performance based management system is an important part of Sunnyvale's Planning and Management System (PAMS). The City began to implement this management concept in the late 1970's by incorporating a system of budgeting that focused on the "outputs" resulting from service provision. This system was further refined in the 1990s to identify and quantify the value created from the efficient/effective provision of City services, with the focus shifting from "outputs" to "outcomes." In FY 2003/2004 Council indicated that it would like to see staff complete a comprehensive review and analysis of the performance based management system. The review and analysis of the system began early in FY 2004/2005 and is expected to be complete by the end of FY 2005/2006. This work is being completed as part of a comprehensive overhaul of the City's Planning and Management System. Work during FY 2004/2005 included evaluation of the philosophy and intent of the system as well as the processes that are followed to either establish a new or restructure an existing program to the performance based management system. A central part of the review process involved a total migration from Outcome Management to Performance Based Budgeting.

Recommended changes to the performance based management system were brought to Council in a study session format in early calendar year 2005. Following approval of the revised system, staff entered into the implementation stage and undertook a major effort to restructure all programs to the revised format. The two-year operating budget starting in FY 2006/2007 represents the culmination of these efforts and marks the beginning of the next phase in Sunnyvale's performance based budgeting system.

OPERATING BUDGET PROCESS

Sunnyvale implemented a two-year operating budget concept in the early 1980's. This is in recognition of the tremendous effort needed to develop budgets, particularly with the City's sophisticated performance based budget system. In normal times, service levels remain relatively constant from year to year. By doing two-year budgeting, staff time is maximized and more in-depth review of each budget element can be accomplished. As indicated earlier, FY 2006/2007 is the first year of a two-year operating budget cycle. Therefore, all operating budgets were extensively reviewed. In addition, rental rates and additive rates for the internal service programs were reviewed, with new rates applied to recover costs. Current salary levels for City employees were adjusted based on existing Memoranda of Understanding or estimated salary trends. Employee benefit costs, especially retirement contributions and health insurance costs were reviewed. For enterprise funds, significant cost components were updated with current information and utility rates were adjusted as appropriate. Finally, major revenue sources were updated for all funds.

PROJECTS BUDGET PROCESS

In the City of Sunnyvale the term "project" refers to non-operating activities. Beginning in FY 1999/2000, the City segregated each project into one of four possible categories: Capital, Infrastructure, Special and Outside Group Funding. These categories are defined as follows:

Capital Projects are major expenditures related to construction, improvement or acquisition of capital assets. This category includes feasibility studies, preliminary plans and other projects that are related to design, construction, capital improvement or acquisition. The construction of a new traffic signal would be a capital project. Other examples include adding a room to an existing facility (capital improvement) or purchasing a piece of property (acquisition).

Infrastructure Projects are inherently related to capital projects. This category includes the renovation and/or replacement of a capital asset. After a capital project is complete, the City has an asset that must be maintained through the operating budget until the asset reaches a point where maintenance costs exceed renovation/ replacement costs. An infrastructure project is developed in order to provide future funds at the time that replacement or renovation is required. An example would be the replacement of major components of the Water Pollution Control Plant or the replacement of the Heating, Ventilation and Air Conditioning (HVAC) system in City Hall.

Special Projects are one-time only in nature and are set up to eliminate the impact that such costs would have on unit costs in operating programs. This category includes studies and other projects that are not related to construction, capital improvements, renovation/ replacement or acquisition of a capital asset. For example, the preparation of a new sub-element of the General Plan would be a special project.

Outside Group Funding Projects are essentially special projects; however, they are established to identify contributions made to local community-based organizations.

Project Operating Costs are those on-going operating costs that will need to be included in future years upon the completion of a given project. These costs are reflected on each Long Term Financial Plan in the *Current Requirements* section under *Project Operating Costs*. Consideration of this information enables decision-makers to evaluate the complete cost of proposed actions. This prevents the City from adding assets or activities that are not sustainable over the long term.

COUNCIL BUDGET REVIEW PROCESS

In FY 2003/2004, Council established a comprehensive annual process to review all City services, service levels, and program budgets to address a continuing structural gap in the City's budget and long-range financial plan. Following this review, Council indicated that it should complete a service and budget review on a regular basis.

During April 2005 the City Council completed its first annual service and program budget review of selected City programs. This review process was set up such that one-eighth of all operating programs would be reviewed each year to give councilmembers serving two consecutive terms the opportunity to review all City programs and services. Due to the scope of the conversion from Outcome Management to the Performance Based Budget, and given the extensive review effort required by Council, it was decided that the one-eighth review process would not be conducted in FY 2005/2006. The City Council plans to revisit the one-eighth review process once the new budget structures are established during FY 2006/2007.

BUDGET FORMAT AND AWARDS

Sunnyvale has a thorough and detailed budget preparation, review and adoption process. Staff has traditionally presented to Council the City Manager's recommended Budget in the form of a workbook. This workbook is used to guide the Council through the budget workshop, the public hearing and finally the official adoption of the budget for the upcoming fiscal year.

The recommended Budget document is divided into three volumes. *Volume I* includes the *City Manager's Transmittal Letter*, *Budget Summary*, *Long-Term Financial Plans*, *Revenues*, *User Fees, and a portion of the City's Operating Programs.* Preceding the operating programs is an *Operating Budget Guide* that describes Sunnyvale's unique Planning and Management System and explains how the City's Performance-Based Budgeting system differs from traditional Line Item Budgeting. *Volume I* is useful as a summary document, with more detailed information found in the other two volumes.

Volume II Operating Budget contains most of the City's programmatic efforts. The Operating Budget is organized around the seven elements of the General Plan (Elements I and II are contained in Volume I). Each element contains the General Plan's Goals, Policies and Action Statements, Community Condition Indicators, and the budget of each operating program that is tied to that particular element. This volume receives detailed attention during the "on year" for operating, which is FY 2006/2007.

Volume III Projects Budget contains all of the City's capital, infrastructure, special and outside group funding efforts. This volume begins with a *Projects Budget Guide* that describes what a project is in the City of Sunnyvale and how projects are prioritized in the budget process. This volume receives detailed attention during the "on year" for projects, which was FY 2005/2006.

In prior years staff has received positive feedback from Council members and citizens regarding the Budget-in-Brief booklet. This is an effort to highlight the important aspects of the particularly large and complex recommended Budget document. This year, staff will again prepare this summary containing the City Manager's Transmittal Letter and Budget Summary.

In December 2005 the Department of Finance was notified that the City's adopted FY 2005/2006 Budget and Ten-Year Resource Allocation Plan had received the Distinguished Budget Presentation Award from the Government Finance Officers Association (GFOA), a national organization of finance professionals. This award program, established in 1984, "recognizes exemplary budget documentation by state, provincial and local government, as well as public universities and colleges." The City has received this award for 17 consecutive years. In addition to qualifying for the award this year, our Budget received "special performance measures" recognition because we were rated outstanding by all raters in the performance measures category.

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